No. 77-1373

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

MAINE CENTRAL RAILROAD COMPANY, *Appellant*,

v.

RAYMOND L. HALPERIN, et al., *Appellees*.

On Appeal from the Supreme Judicial Court of Maine

JURISDICTIONAL STATEMENT

PETER J. NICKLES
EUGENE D. GULLAND
MARC B. TUCKER
COVINGTON & BURLING
888 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 452-6000

WILLIAM C. SMITH
JAMES G. GOOD
PIERCE, ATWOOD, SCRIBNER, ALLEN, SMITH & LANCASTER
One Monument Square
Portland, Maine 04111
(207) 773-6411

Attorneys for Maine Central Railroad Company

Of Counsel:

SCOTT W. SCULLY
General Counsel
MAINE CENTRAL RAILROAD COMPANY
242 St. John Street
Portland, Maine 04102
(207) 773-4711

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JURISDICTIONAL STATEMENT

Maine Central Railroad Company appeals the judgment of the Supreme Judicial Court of Maine sustaining the validity, under the United States Constitution, of the Maine Railroad Excise Tax so applied as to include in the calculation of the tax income earned from federal incentive per diem charges and a substantial amount of income earned outside of Maine.

OPINIONS BELOW

The opinion of the Supreme Judicial Court of Maine is reported at 379 A.2d 980 and is reprinted in the Appendix at pages 1a-24a below.[1] The further opinion of the Supreme Judicial Court on reconsideration is reported at 381 A.2d 8 and is reprinted in the Appendix at pages 24a-31a below. The order of the Superior Court on remand, entered December 30, 1977, is reprinted in the Appendix at pages 32a-33a below.

JURISDICTION

Appellant brought this action in the Superior Court for Kennebec County, Maine, seeking a judgment declaring that Maine's Railroad Excise Tax was unconstitutional in its application to appellant's incentive per diem income or, alternatively, to appellant's compensatory and incentive per diem income earned outside Maine. The case was referred to the Supreme Judicial Court for decision upon an agreed statement of facts. On November 16, 1977, the Supreme Judicial Court entered an opinion and judgment upholding the constitutionality of the Railroad Excise Tax against appellant's challenges. Upon appellant's motion for reconsideration, the Supreme Judicial Court entered a further opinion on December 27, 1977, reaffirming its judgment for appellees.

Appellant filed notices of appeal to this Court in both the Supreme Judicial Court and the Superior Court on January 13, 1978 (p. 34a, *infra*). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(2). Cases that sustain this Court's jurisdiction include *Norfolk and Western Ry.* v. *Missouri State Tax Comm'n.,* 390 U.S. 317 (1968); *Southern Ry.* v. *Kentucky,* 274 U.S. 76 (1927); and *Dahnke-Walker Milling* v. *Bondurant,* 257 U.S. 282 (1921).

[1] Citations to portions of the Record that are not included in the Appendix are in the form "(R. —)." Appellant has requested that the record be certified to this Court.

STATUTES INVOLVED

The Maine Railroad Excise Tax is codified at 36 M.R.S.A. §§ 2623 *et seq.* The full text of the Maine Railroad Excise Tax is reprinted in the Appendix at pages 35a-39a below. The provision of special relevance to this case, 36 M.R.S.A. § 2624, provides in pertinent part:

§ 2624. Amount of tax

> The amount of the annual excise tax on railroads shall be ascertained as follows: The amount of the gross transportation receipts as returned to the Public Utilities Commission for the year ended on the 31st day of December preceding the levying of such tax shall be compared with the net railway operating income for that year as returned to the Public Utilities Commission. When the net railway operating income does not exceed 10% of the gross transportation receipts, the tax shall be an amount equal to 3¼% of such gross transportation receipts. When the net railway operating income exceeds 10% of the gross transportation receipts but does not exceed 15%, the tax shall be an amount equal to 3¾% of the gross transportation receipts.
>
> * * *
>
> When a railroad lies partly within and partly without the State, or is operated as a part of a line or system extending beyond the State, the tax shall be equal to the same proportion of the

> gross transportation receipts in the State, and its amount shall be determined as follows: The gross transportation receipts of such railroad, line or system, as the case may be, over its whole extent, within and without the State, shall be divided by the total number of miles operated to obtain the average gross transportation receipts per mile, and the gross transportation receipts in the State shall be taken to be the average gross transportation receipts per mile multiplied by the number of miles operated within the State, and the net railway operating income within the State shall be similarly determined.
>
> The term "net railway operating income" means railway operating revenues less the railway operating expenses, tax accruals and uncollectible railway revenues, including in the computation thereof debits and credits arising from equipment rents and joint facility rents. The Public Utilities Commission, after notice and hearing, may determine the accuracy of any returns required of any railroad, and if found inaccurate, may order proper corrections to be made therein.

Section 1(14)(a) of the Interstate Commerce Act, 49 U.S.C. § 1(14)(a), which authorizes the Interstate Commerce Commission to impose incentive charges on the use of boxcars, is reprinted in the Appendix at pages 39a-40a. The regulations of the Interstate Commerce Commission implementing 49 U.S.C. § 1(14)(a), which are codified at 49 C.F.R. §§ 1036, *et seq.*, are reprinted in the Appendix at pages 40a-46a.

QUESTIONS PRESENTED

The Maine Railroad Excise Tax is a franchise tax measured by the gross receipts of railroads operating within Maine. The percentage of gross receipts to be paid as tax is determined by the ratio of the railroad's

"net railway operating income" ("NROI") to its gross taxable receipts: the higher the NROI in relation to taxable gross receipts, the higher is the railroad's tax rate. The tax payable is calculated by a mileage prorate formula that apportions to the state a percentage of the railroad's gross receipts and NROI that is determined by the ratio of the railroad's miles of line lying within Maine to its total miles of line.

With the goal of alleviating a critical nationwide shortage of boxcars, the Interstate Commerce Commission has established incentive per diem ("IPD") charges, which are a rental that a railroad receives from other carriers, in addition to compensatory per diem charges, as an incident of those carriers' use of its boxcars. The purpose of the incentive charge is to induce railroads to acquire boxcars. Under the Commission's regulations, a railroad does not own IPD receipts but instead holds them in trust for only two uses: acquisition of boxcars and payment of state and federal income taxes attributable to IPD income itself. IPD income cannot be used to pay excise tax attributable to such income.

Appellant sought to exclude its IPD income from its NROI in computing its 1974 excise tax and, on that basis, paid an excise tax of $70,623. State tax officials recomputed the tax including all IPD income earned in 1974 and assessed a deficiency of $615,760. The questions presented are:

1. Whether application of the Maine Railroad Excise Tax to restricted incentive per diem income conflicts with federal law and federal transportation policy, in contravention of the Supremacy Clause of the United States Constitution.

2. Whether the mileage apportionment formula of the Maine Railroad Excise Tax, which in 1974 attributed to Maine for tax purposes about 84 percent of IPD and compensatory per diem income when about 97 percent of such income was in fact earned from operations outside Maine, may be applied consistently with the Due Process Clause of the Fourteenth Amendment and the Commerce Clause of the United States Constitution because the Excise Tax is characterized as a "franchise" tax *measured* by income and receipts, rather than as a tax on income or receipts themselves.

STATEMENT

This case emerges from the efforts of Maine to include in its railroad excise tax computations appellant's federal incentive per diem receipts, the majority of which are earned outside of Maine. Appellant resisted the inclusion of restricted IPD income in the computation of its 1975 excise tax and brought suit in state courts alleging that application of the excise tax to IPD receipts would hinder and frustrate the federal IPD program, impose a burden on interstate commerce, and impermissibly tax activities conducted beyond Maine's jurisdiction. The state courts rejected appellant's arguments, and appellant brings this appeal.

A. Factual Background

Appellant operates a railroad with lines in Maine, New Hampshire, Vermont and New Brunswick. Among the taxes to which appellant is subject is the Maine Railroad Excise Tax, 36 M.R.S.A. §§ 2623-2628. (See pp. 35a-39a, *infra.*)

The Maine Railroad Excise Tax is a franchise tax measured by the gross receipts of railroads operating

in the State of Maine, subject to several computations of significance to this case.[3] First, the tax rate is determined by the ratio of the railroad's "net railway operating income" ("NROI") to its gross receipts; as the ratio becomes higher, the railroad moves into higher percentage tax brackets, which range from 3.25 percent to 5.25 percent of the railroad's taxable gross receipts. Because gross receipts include all revenues, without deduction for costs of generating the revenues, very small increases in the tax rate can result in large increases in the unapportioned tax. Second, the excise tax payable to Maine is calculated by a mileage prorate formula that apportions to Maine the same proportion of the railroad's gross receipts, NROI and unapportioned tax as the railroad's miles of line in Maine bear to the railroad's total miles of line. *See* 36 M.R.S.A. § 2624. Third, the tax is subject to reduction by a "diminishment amount," which equals the amount by which the railroad's NROI falls below 5¾ percent of its investment in railway property devoted to transportation use, less depreciation, plus cash assets and the value of material and supplies on hand. *Id.* The purpose of this provision is to reduce the impact of the tax on railroads during years in which their earnings are relatively poor.

Triggering this litigation was appellant's large amount of restricted IPD income and receipts during 1974, when the Interstate Commerce Commission directed all rail carriers to impose IPD charges on a year-round basis, at higher rates than in the past, for the purpose of alleviating the critical shortages of box-

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[3] A chart comparing the computation of appellant's 1975 excise tax with and without inclusion of IPD receipts appears at R. 185.

cars caused by the continuing shipment of grain to the Soviet Union and other nations. The Commission has been empowered to impose *compensatory* daily, or per diem, charges on the use of one carrier's boxcars by others since enactment of the Esch Car Service Act of 1917, 40 Stat. 101. In 1966, Congress amended Section 1(14)(a) of the Interstate Commerce Act, 49 U.S.C. § 1(14)(a), to authorize the Commission to include an extra, "incentive," component in per diem charges for the purpose of encouraging railroads to acquire boxcars.[3]

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[3] Twice in recent years this Court has had occasion to recount at length the history of how federal regulation of per diem charges has served as a means of influencing the nationwide distribution and utilization of boxcar equipment. *See* United States v. Florida East Coast Ry., 410 U.S. 224 (1973); United States v. Allegheny-Ludlum Steel, 406 U.S. 742 (1972).

With the enactment of the Interstate Commerce Act in 1887, regulated railroads were no longer permitted to decline to exchange their boxcars with other carriers subject to the Act. The result was that the freight cars across the nation "became in essence a single common pool, used by all roads." United States v. Allegheny-Ludlum Steel Corp., *supra*, 406 U.S. at 743. For many years, railroads paid one another rentals for the use of one another's boxcars; the Esch Car Service Act of 1917 sought to solve the problems of boxcar shortages aggravated by wartime conditions by empowering the ICC to establish a system of compensatory per diem charges under which carriers would be encouraged to acquire boxcars, and be less likely to cover their own shortages of boxcars by using boxcars belonging to other carriers.

The 1966 amendments authorizing the ICC to include an "incentive" element in per diem charges were designed to remedy a severe shortage of boxcars by penalizing carriers that failed to acquire an adequate number of boxcars for their needs and by offering railroads a rate of return on boxcars sufficient to make the acquisition of boxcars an attractive investment. *See* United States v. Florida East Coast Ry., *supra*, 410 U.S. at 230-34; H.R. Rep. No. 1183, 89th Cong., 1st Sess., p. 1, *et seq.* (1965); S. Rep. No. 386, 89th Cong., 1st Sess., p. 1, *et seq.* (1965).

In 1970, the Commission promulgated regulations establishing an incentive per diem program. Among the chief features of the regulations as issued, and as they have been amended since, are the numerous restrictions governing carriers' ownership and use of the "credit balance"—the excess of a carrier's IPD receipts over its IPD payments. The regulations have always required that credit balances be "earmarked" —that they be segregated from all other cash assets of the railroad. The earmarked funds may be used only for two purposes: (1) to acquire boxcar equipment by purchase, building, rebuilding or lease; and (2) to pay both federal and state income taxes directly attributable to the IPD credit balances themselves. 49 C.F.R. § 1036.3 (1976). The Commission has explained its intention that

> "Earmarking for a specific purpose thus removes [IPD credit balances] from the general funds of the carrier. The incentive funds can be traced from the time they reach the individual railroad to the appropriate accounts in which they are retained and, in effect, held in trust. An analogy is the various statutory trusts that may be created when a bankrupt collects sales taxes. The incentive credit balances collected by the railroads do not become part of the general assets of the railroads." *Incentive Per Diem Charges,* 343 I.C.C. 49, 56 (1973).

Indeed, the Commission has reserved the power to investigate circumstances in which carriers do not make use of IPD credit balances, with an eye toward requiring surrender of the funds. *See* 49 C.F.R. § 1036.4 (1976); *Incentive Per Diem Charges,* 349 I.C.C. 303, 319-20 (1975).

The regulations have also always required that no carrier may make use of IPD credit balances until

it has first spent a prescribed amount of its own general corporate funds to acquire boxcar equipment. The purpose of this restriction has been to ensure that carriers do not use IPD credit balances to acquire equipment they would likely have acquired in any event. This restriction has been implemented by requiring that, before it uses IPD funds to acquire equipment in any year, a carrier must first have acquired in that and each preceding year the same number of boxcars that it acquired annually, on the average, during the years 1964-68. 49 C.F.R. § 1036.4 (1976).

Until 1974, appellant's IPD credit balances had not resulted in increasing its excise tax liability. In that year, however, a large credit balance accumulated because the Commission increased IPD charges. The funds were placed in the earmarked IPD fund. In accordance with the Commission's regulations, 49 C.F.R. 1036.3 (1976), appellant used IPD funds to pay the federal and Maine income tax on the credit balance income. But, when it filed its 1975 excise tax return, appellant did not include in its NROI approximately $1.87 million, representing the 1974 IPD credit balance less federal and state income taxes on IPD income. (Appellant included within its excise tax NROI and gross receipts, by contrast, compensatory time and mileage per diem income.) Appellant computed its 1975 excise tax at $70,623, on the basis that its proper tax rate was 3.25 percent and that it was entitled to an appropriate "diminishment amount."

The State Tax Assessor disagreed with appellant's exclusion of net incentive per diem income from NROI because, even though the new federal IPD program restricted appellant's legal interest in and right to use IPD funds, the excise tax had long defined NROI to

include "credits arising from equipment rents." On his calculation of appellant's excise tax for 1975, appellant owed $686,383; the Assessor demanded that Maine Central pay the full amount of the tax as calculated with IPD income included within NROI.

B. The Proceedings Below

Appellant brought this action in the Superior Court for Kennebec County, Maine. Appellant prayed for a judgment declaring that Section 2624 of the excise tax statute did not include IPD credit balances within its definition of "net railway operating income." In the event that the statutory definition of NROI was held to embrace IPD credit balances, appellant sought a judgment declaring that application of the excise tax to its IPD credit balances frustrated the full effectiveness of the federal IPD program in conflict with the Supremacy Clause of the United States Constitution. Appellant also sought a judgment declaring that application of the excise tax to appellant's 1974 IPD credit balance and compensatory per diem income improperly burdened interstate commerce and taxed activity occurring beyond Maine's jurisdiction in violation of the Commerce Clause and Due Process Clause of the Fourteenth Amendment, because the excise tax apportioned to Maine 84.25 percent of all per diem receipts, while more than 97 percent of such receipts were earned from the movement of appellant's boxcars outside the State of Maine. The Interstate Commerce Commission intervened as *amicus curiae* and joined appellant in opposing application of the Maine Railroad Excise Tax to appellant's IPD credit balance.

In accordance with practice in the courts of Maine, the Superior Court certified the case to the Supreme

Judicial Court of Maine for resolution on a statement of stipulated facts in which appellant, appellees, and the Interstate Commerce Commission each concurred. After briefing and oral argument, the Supreme Judicial Court resolved all issues for appellees and remanded the case to the Superior Court for entry of judgment.

The Supreme Judicial Court rejected the Interstate Commerce Commission's view that IPD credit balances are restricted funds held in trust—a view expressed in both its briefs to the court below and in the Commission decisions promulgating and interpreting IPD regulations; the Court observed that "[t]his is a loose use of the 'trust' concept which confuses . . . correct analysis of the issue before us." (P. 8a, *infra.*) Without analyzing the federal restrictions on ownership and use of IPD credit balances, and the impact of those restrictions on appellant's ability to use IPD funds, the court below held that the "owning railroad is the primary beneficiary of the [IPD] charges." (*Id.*) On that basis, the court held that IPD receipts increase the "value of the franchise" in a manner warranting imposition of the excise tax on IPD credit balances without regard to the restrictions on use of the funds.

Applying a self-conceived balancing analysis, the court below also held that application of the excise tax to appellant's IPD credit balance did not unduly hinder or frustrate the federal IPD program in violation of the Supremacy Clause of the United States Constitution. It said that, despite the tax, appellant would continue to have some, albeit a diminished, incentive to acquire boxcars. (Pp. 11a-12a, *infra.*) The court minimized the problems posed by the need to pay the excise tax out of general corporate funds that otherwise would

be applied to acquiring boxcars to satisfy the IPD "base period" requirements: it explained that appellant could make "appropriate use of its financial planning resources" to limit its IPD credit balances to a level that would not burden general corporate assets with the obligation to pay higher excise taxes. It added that, in any event, the frustration of appellant's ability to use IPD receipts for the acquisition of boxcar equipment would not unduly hinder the IPD program other than in Maine. (Pp. 13a-15a, *infra.*) The court reasoned that, if appellant could not use its IPD credit balances, the funds might be surrendered to others for their use in acquiring boxcars. (*Id.*)

Finally, the court below rejected appellant's challenge to the manner in which the mileage apportionment formula resulted in Maine's allocation to itself for tax purposes some 84.25 percent of all per diem income, when more than 97 percent of that income had been earned from the movement of boxcars outside the State of Maine. The court reasoned that the excise tax was an "apportioned" tax and that, so long as some effort were made to apportion the tax, a "rough approximation" was sufficient to avoid burdening interstate commerce. (Pp. 18a-19a, *infra.*) The court explained that, in any event, the question of fair apportionment is of little significance in this case because the Maine Railroad Excise Tax merely *measures* the tax by reference to an apportionment of income and gross receipts. The tax itself, the Court emphasized a number of times, is levied directly on franchise values, not on income or receipts. (Pp. 27a-29a, *infra.*)

The Supreme Judicial Court remanded the case to the Superior Court for the entry of judgment. On December 30, 1977, the Superior Court entered judg-

ment for appellees in the amount of $756,849.12. (Pp. 32a-33a, *infra.*)

THE QUESTIONS PRESENTED ARE SUBSTANTIAL

I. Application Of The Maine Railroad Excise Tax To Appellant's Incentive Per Diem Income Frustrates The Full Effectiveness Of The Federal Incentive Per Diem Program In Violation Of The Supremacy Clause Of The Constitution.

The opinion of the court below upholds imposition of the Maine Railroad Excise Tax in a manner that interferes with the federal IPD program. On its own view that railroads such as appellant are the real "beneficiaries" of IPD charges, the court accorded no weight to the numerous restrictions the Commission has placed on IPD funds for the purpose of ensuring that railroads hold them in trust for the acquisition of boxcars.

In consequence, appellant was charged with an excise tax that was calculated by reference to restricted IPD funds as they were received. In fact, these funds could not be used until the Commission's restrictions were satisfied and the funds were actually devoted to the acquisition of boxcars. They could not be used to pay the increased excise tax they generated. Such taxation of IPD funds is at odds with the Commission's express intention that no railroad's general corporate assets should be burdened by increased tax liability attributable to restricted IPD income. Not only is the inclusion of IPD income in the calculation of the excise tax inconsistent with the Commission's intent, it also reduces the rate of return on boxcar investment deemed necessary by the Commission to induce carriers to acquire boxcar equipment and can, as illustrated by appellant's case, actually make it disadvantageous for a

carrier to receive IPD income. For these reasons, the Maine Railroad Excise Tax as applied to include restricted IPD income frustrates the full effectiveness of the federal IPD program and therefore violates the Supremacy Clause of the United States Constitution.

Taking into account these considerations, an Interstate Commerce Commission official stated, in uncontradicted and stipulated testimony, that imposition of the excise tax in the manner endorsed by the court below hinders and impedes the federal IPD program:

> "In my opinion, the assessment of an excise tax computed under the Maine Excise Tax provisions, as interpreted by the State of Maine Tax Assessor, against railroads having a net credit balance of Incentive Per Diem Charges is contrary to the intent of the Commission and would have a substantial adverse effect upon and conflict with the policies and goals of the Commission in this area." (R. 202.)

Save for a brief footnote reference (p. 16a, n.11, *infra*), the court below paid as little heed to the testimony and arguments of the Commission as it did to the intent and structure of the regulations implementing the Federal IPD program. The court did so because it engaged in an analysis rooted in an erroneous conception of federalism, under which it thought that its role was to find a means of accommodating conflicting state and federal law, rather than enforcing federal law as paramount in circumstances where state law threatens achievement of the full range of federal objectives.

1. Since the early days of the nation's history, the legal foundations of federalism have rested on the principle that "the states have no power, by taxation or otherwise, to retard, impede, burden, or in any man-

ner control the operation of the constitutional laws enacted by congress to carry into execution the powers vested in the general government." *McCulloch* v. *Maryland,* 17 U.S. (4 Wheat.) 315, 435 (1819). As restated more recently, this "controlling principle" commands that "any state legislation which frustrates the full effectiveness of federal law is rendered invalid by the Supremacy Clause." *Perez* v. *Campbell,* 402 U.S. 637, 652 (1971); *see also Ray* v. *Atlantic Richfield,* —— U.S. —— (No. 76-930, decided March 6, 1978), slip op. at p. 5; *Nash* v. *Florida Industrial Comm'n,* 389 U.S. 235, 240 (1967); *Sears, Roebuck & Co.* v. *Stiffel,* 376 U.S. 225, 229 (1964); *Colorado Anti-Discrimination Comm'n* v. *Continental Air Lines,* 372 U.S. 714, 722 (1963); *Free* v. *Bland,* 369 U.S. 663, 666 (1962); *Hill* v. *Florida,* 325 U.S. 538, 42 (1945); *Hines* v. *Davidowitz,* 312 U.S. 52, 67 (1941).

Congress enacted Section 1(14)(a) of the Interstate Commerce Act, 49 U.S.C. § 1(14)(a), because "since World War II [boxcar shortages] have become chronic." H.R. Rep. No. 1183, 89th Cong., 1st Sess. 2 (1965). To deal with this crisis of nationwide proportion, Congress authorized the Interstate Commerce Commission to apply its expertise to the task of structuring an incentive per diem program. In fixing per diem compensation under Section 1(14)(a), the Commission was empowered to take into account the national level of ownership of freight cars and other factors affecting freight car ownership, and to determine

> "whether such [per diem] compensation should be increased by such incentive element or elements of compensation as in the Commission's judgment will provide just and reasonable compensation to freight car owners, contribute to sound car service practices (including efficient utilization and distribution of cars), and encourage the acquistion and maintenace of a car supply adequate to meet the needs of commerce and the national defense."

When the Commission promulgated regulations for the implementation of Section 1(14)(a), those regulations received the protection of the Supremacy Clause. *See, e.g., Free* v. *Bland,* 369 U.S. 663 (1962); *Miller* v. *Arkansas,* 352 U.S. 187 (1956).

The court below heeded none of these principles. Instead, it employed a wholly novel—and erroneous—standard in determining whether the application of the excise tax conflicted with federal law. The Court applied a balancing analysis, under which it concluded that the federal regulations must give way to the excise tax to the extent that federal objectives could be achieved through alternative means that would not burden the State's collection of the excise tax. It explained that the accommodation of state and federal objectives struck by the balancing analysis was rooted in "the relativity of the values at stake and the lack of any single generalized guiding principle." (P. 10a, *infra.*) This analysis utterly ignored the "single generalized guiding principle" that state law must yield where its application *"frustrates the full effectiveness of federal law."*

2. The court below attached no significance to the Commission's oft-expressed policy that restrictions on the use of IPD credit balances, which forbid use of the funds for general corporate purposes, are the heart of the regulatory scheme. The Commission has explained that

> "In the absence of earmarking, the net incentive balances would obviously be deposited in the general funds of the railroads, which could then be

> expended for many purposes having little or nothing to do with the purposes of the statute. The statute was not adopted to provide the railroads with merely increased compensation for the use of the cars . . . . The net balances derived from the incentive charge are not properly part of the working capital of the railroad." *Incentive Per Diem Charges,* 337 I.C.C. 217, 227-28 (1970).

The Commission has made clear that the earmarking of funds is meant to impose restrictions not only on the railroad receiving IPD payments, but on its creditors, as well. The Commission has issued an interpretive ruling holding that, because IPD receipts are earmarked and "in effect held in trust" for the benefit of the nation's boxcar needs as a whole, the creditors of a railroad in bankruptcy may not invade the bankrupt's restricted IPD fund. *Incentive Per Diem Charges,* 343 I.C.C. 49, 56 (1973).[4]

The court below, by contrast, concluded that "the owning railroad is the primary beneficiary of the [IPD] charges." (P. 8a, *infra.*) It correctly observed (*id*) that cars acquired with IPD funds "become the outright property of the railroad." *See* 49 C.F.R. § 1036.3 (1976); *Incentive Per Diem Charges,* 343 I.C.C. 49, 56 (1973). But the Court ignored that "IPD charges are regulatory and not compensatory." *Illinois Terminal R.R.* v. *United States,* 541 F.2d 201, 206 (8th Cir. 1976), *cert. denied,* 430 U.S. 906 (1977). It did not limit application of the excise tax to the "increased

[4] *Cf.* Matter of Chicago, R.I. & P.R.R., 537 F.2d 906 (7th Cir. 1976), in which the court of appeals held that the Commission's authority over compensatory per diem and IPD charges supersedes the power of a reorganization court to prescribe the classification and priority of a bankrupt railroad's per diem creditors.

value of the franchise" attributable to boxcars actually acquired with IPD credit balances. Instead, the court permitted the tax to be levied directly on the IPD credit balances themselves.[5]

The court's refusal to give weight to the restrictions the Commission has imposed on ownership and use of IPD funds clashes with the IPD regulations for the further reason that the Commission "did not envision or intend that [IPD] charges would result in added financial burdens on the corporate earnings and assets of creditor railroads." (R. 202.) Since IPD funds can be used only for the acquisition of boxcars or the payment of income taxes attributable to IPD credit balances, 49 C.F.R. § 1036.3 (1976), appellant's general corporate assets are burdened with the obligation to pay the Maine Railroad Excise Tax in precisely the manner that the Commission's IPD regulations meant to prevent.

3. The Supreme Judicial Court's refusal to accord weight to the Commission's earmarking and other restrictions on the ownership and use of IPD funds was but the first way in which the court's decision threatens to unravel a tightly-knit regulatory scheme. It is striking that the court's opinions fail entirely to

[5] This flaw in the court's reasoning produced a further inconsistency: it observed that, if appellant were unable to make use of IPD credit balances to acquire boxcars, the funds might have to be surrendered under federal regulations making them available for others to use for acquiring boxcars. (Pp. 14a-15a, *infra.*) The court seemingly failed to recognize that, in such an event, appellant would have paid an excise tax on IPD credit balances which it might never use to increase "the value of the franchise."

address the evidence and arguments adduced below concerning the ways in which application of the excise tax to appellant's IPD receipts undermines the goals of the Commission's IPD regulations by reducing the carriers' incentive to buy boxcars and by threatening their ability to benefit from IPD credit balances.

In establishing the amount of IPD charges, the Commission deliberately sought to "establish a level, which when combined with the basic per diem charge, would produce an annual 12 percent rate of return on investment in general unequipped service boxcars." (R. 197.) The purpose of the targeted rate of return was to "produce an incentive for the railroads to invest in general service unequipped boxcars rather than investing in nontransportation enterprises." (*Id.*) In computing the targeted rate of return, the Commission took into account the impact of both federal and state income taxes and assured the target rate of return by authorizing railroads to pay the income taxes attributable to IPD income from the restricted IPD fund itself. *Id.*; 49 C.F.R. § 1036.3 (1976). The Commission intended that no other taxes would be imposed on IPD income. (P. 19, *supra*; R. 197-200.) [6]

Appellant's circumstances illustrate several distinct ways in which the unforeseen financial burden imposed on the corporate assets of carriers by the excise tax could frustrate the Commission's regulatory scheme. In the first place, the amount of the excise tax attributable to the restricted IPD credit balance received in

[6] *See also* R. 46, 50-52, 76, 87; Incentive Per Diem Charges, 337 I.C.C. 183, 187-89, 213, 224 (1969); Florida East Coast Ry. v. United States, 368 F. Supp. 1009, 1016-17 (M.D. Fla. 1973) (three-judge court), *aff'd per curiam*, 417 U.S. 901 (1974).

1974—some $615,000—exceeded appellant's total ordinary net income for the years 1974 and 1975 by a substantial amount. In consequence, appellant earned insufficient general corporate funds in those years with which to acquire any boxcars, and with which to satisfy "base period" rules conditioning use of IPD credit balances. That fact underscores the anomaly of assessing a tax on hypothetical increases of "value of the franchise" when the tax itself could prevent use of IPD funds to increase the value of the franchise.

Second, application of the excise tax to IPD credit balances frustrates the federal IPD program by reducing substantially the 12 percent target rate of return on boxcar equipment that the Commission concluded would be a sufficient incentive to induce carriers to invest in additional boxcar equipment. Third, the excise tax can, as in the case of appellant, actually make it disadvantageous to receive IPD income, for even though a railroad might not be able to use the funds to acquire boxcars, it nevertheless can be charged with paying, from general corporate funds, an additional tax. That, indeed, was precisely the conclusion of a Commission official:

> "If corporate funds must be tapped to pay the increased excise tax, the attractiveness of the investment in boxcars which would generate more Incentive Per Diem Charges is obviously not as great as it is when the railroad does not experience this increased financial burden. The extreme example is found in the case of Maine Central Railroad where the inclusion of the Incentive Per Diem Charges results in an excise tax larger than the net ordinary income for the years 1974 and 1975 available to pay that tax. In my opinion, in such a situation, the imposition of an excise tax so com-

puted would have a severe adverse effect on the incentive which the Commission intended to create when it adopted Incentive Per Diem Charges." (R. 200.)

It is no answer to the problem of frustration of the federal IPD program to say, as did the court below, that "appropriate use of its financial planning resources will enable Maine Central readily to compute the level at which generation of additional incentive charges will excessively burden general corporate assets." (P. 14a, *infra.*) Appellant must permit other carriers to use its boxcars. Perhaps appellant could have waived collection of IPD charges, although it is far from clear that the Commission would have permitted it to do so. But that stark alternative only dramatizes the way in which the application of the excise tax frustrates the federal IPD program.

4. The court below acknowledged that the application of the excise tax to IPD credit balances burdens the federal IPD program to some extent. But the court concluded that the goals of the federal program could be satisfactorily attained by means other than those which the Commission has preferred. Thus, the court found that the IPD program would not be totally frustrated because the Commission could direct in the future that appellant's unused IPD funds be surrendered for use by other carriers or boxcar owners. (Pp. 14a-16a, *infra.*)

The Court's incursion into federal policy-making ignores that the Commission's regulations clearly contemplate that surrender of IPD funds is a last resort. The preferred mechanism for implementing the goals of the IPD program is for railroads to use their ac-

cumulated IPD credit balances to acquire their own boxcars. 49 C.F.R. § 1036.4 (1976). The Commission never contemplated that carriers would be denied the use of IPD credit balances by reason of burdens imposed by state legislation. Indeed, the Commission has intended that IPD program would assist carriers that both need and possess a large boxcar supply because "such roads are generally the very railroads that show the most serious need for cars in the heavy loading season." *Incentive Per Diem Charges,* 337 I.C.C. 217, 227 (1970). Appellant—which is located in the extreme northeastern corner of the nation and which originates lumber and paper products on its lines—has special need for a large supply of boxcars. In the proceedings below, no party disputed the fact that appellant's geographical remoteness and the needs of its shippers require appellant to possess "a technically excess supply of cars" and that the IPD program is indispensable if appellant is to obtain the cars it needs. (R. 206). The court below was completely insensitive to the fact that it is the very purpose of the IPD program to assist carriers in appellant's position. The court's views of appropriate transportation policy must yield to the Commission's.

5. From what we have said, we believe it evident that the opinion of the court below authorizes the implementation of a state taxation statute in a manner that "frustrates the full effectiveness of federal law." *Perez* v. *Campbell,* 402 U.S. 637, 652 (1971). The Supreme Judicial Court's balancing test has no sanction in the law and leads to results that infringe important federal interests.

II. Application Of The Maine Railroad Excise Tax To Appellant's Per Diem Income Imposes A Burden On Interstate Commerce And Taxes Activity Beyond Maine's Jurisdiction.

Because 84.25 percent of appellant's miles of line lie within Maine, Section 2624 of the Maine Railroad Excise Tax conclusively presumes that 84.25 percent of appellant's gross receipts and NROI are subject to Maine's taxing power. In 1974, more than 80 percent of appellant's NROI was attributable to compensatory and incentive per diem receipts, and more than 97 percent of those receipts were earned from the movement of appellant's boxcars outside the State of Maine. Nevertheless, the Tax Assessor apportioned appellant's per diem income in accordance with the statutory formula and presumed that 84.25 percent of that income was attributable to Maine. Had per diem income been apportioned to Maine on a basis reflecting the income actually earned within Maine, appellant's 1975 excise tax would have been $70,623 instead of $686,383. The Supreme Judicial Court upheld the application of the apportionment formula because it believed that a "rough approximation" is all that is required under the circumstances (p. 19a, *infra*) and because it thought that a "franchise" tax measured by income and gross receipts is not subject to the rules this Court has laid down for apportioning taxes levied directly on income and receipts themselves. (Pp. 26a-29a, *infra.*)

1. The decision of the court below upholding the application of the apportionment formula is contrary to repeated decisions of this Court imposing constitutional limitations to govern the rules of thumb employed by states to determine the reach of their authority to tax businesses operating both within and beyond their territory. The court below placed great weight on the fact that the mileage prorate formula used by Maine, applied in somewhat different form, was sustained in *Maine* v. *Grand Trunk Ry.*, 142 U.S. 217 (1891). To be sure, such a general formula is valid when it may fairly be assumed that a railroad's income, receipts or property are allocable among states for tax purposes in rough proportion to the mileage in each state. But the formula must give way where its automatic or mechanical application results in the taxation of property or activity beyond the state's jurisdiction.

In *Fargo* v. *Hart*, 193 U.S. 490, 499-500 (1904), Mr. Justice Holmes explained that it is "reasonable and constitutional to get at the worth of [a line of railroad] in the absence of anything more special, by a mileage proportion . . . so long as it fairly may be assumed that the different parts of a line are about equal in value." But if a railroad "had terminals in one State equal in value to all the rest of the line through another, the latter State could not make use of unity of the road to equalize the value of every mile. That would be taxing property outside of the State under a pretense." *Id.* Application of the mileage formula in *Fargo* transgressed both the Due Process Clause of the Fourteenth Amendment and the Commerce Clause because, "[i]t involved an attempt to tax property beyond the jurisdiction of the State, and to throw an unconstitutional burden on commerce among the States." *Id.* at 502; *see also Wallace* v. *Hines*, 253 U.S. 66, 69 (1920); *Union Tank Line Co.* v. *Wright*, 249 U.S. 275, 282 (1919).[7]

[7] Numerous decisions of this Court reaffirm that "the test whether a particular state exaction is such as to invade the authority of Congress to regulate trade between the States, and the test for a

Even a tax formula that is lawfully imposed for many years—like the mileage apportionment formula of the Maine Railroad Excise Tax—may become unlawful in its application to a particular year's exceptional circumstances. In *Norfolk & Western Ry.* v. *Missouri State Tax Comm'n,* 390 U.S. 317 (1968), this Court held that Missouri's mileage apportionment formula could no longer be constitutionally applied to a railroad after it acquired additional properties within the state whose average value per mile was far below the average value per mile of its properties lying outside the state. In such circumstances, this Court wrote, the state is obliged by the Constitution to make appropriate modifications in the taxing formula:

> "But when a taxpayer comes forward with strong evidence tending to prove that the mileage formula will yield a grossly distorted result in its particular case, *the State is obliged to counter that evidence or to make the accommodations necessary to assure that its taxing power is confined to its constitutional limits.* If it fails to do so and if the record shows that the taxpayer has sustained the burden of proof to show that the tax is so excessive as to burden interstate commerce, the taxpayer must prevail. 390 U.S. at 329." (Emphasis supplied.)

As if oblivious to the weight of precedent, the court below was content to sweep aside the remarkable fact

State's compliance with the requirements of due process in this area are similar." Nat'l Bellas Hess, Inc. v. Dept. of Revenue, 386 U.S. 753, 756 (1967); *see also* Central R.R. v. Pennsylvania, 370 U.S. 607, 612 (1962); Ott v. Mississippi Valley Barge Line, 336 U.S. 169, 174 (1949). The due process claim arises because tax is imposed on out-of-state value that is beyond the legitimate reach of the taxing state. Miller Bros. Co. v. Maryland, 347 U.S. 340, 342 (1954); Greenough v. Tax Assessors, 331 U.S. 486, 491 (1947); *Cf.* American Oil Co. v. Neill, 380 U.S. 451, 457-59 (1965).

that Maine had allocated to itself some 84 percent of per diem income, of which some 97 percent had indisputably been earned from operations conducted outside the State of Maine, with the observation that a "rough approximation, as a practical matter, is the norm of any state taxation system." (P. 19a, *infra.*) There is no sanction in the Constitution and no precedent in the decisions of this Court for an approximation nearly so rough as Maine's in this case.

2. Perhaps the court below meant its "rough approximation" standard for fair apportionment to be read in conjunction with its extended discussion of why, in its view, a franchise tax *measured* by gross receipts and NROI need not be apportioned with the same precision as a tax laid directly on gross receipts and NROI themselves, or upon the assessed value of personal property. (Pp. 20a-21a, *infra.*) The court based this analysis on the proposition that, because the Maine Railroad Excise Tax is levied on the "value of the franchise," Maine could ignore the source of components of appellant's receipts, NROI and other "franchise" value. (Pp. 20a-22a, *infra;* pp. 26a-27a, *infra.*)

There are two fundamental flaws in the Court's analysis. In the first place, the Court is incorrect to assume that invocation of the words "franchise value" or "intangible values" shields from constitutional scrutiny the accuracy of an apportionment formula. It is clear, of course, that fair apportionment is required no less of a state tax because it is denominated a "franchise" tax. *See, e.g., Southern Ry.* v. *Kentucky, supra,* 274 U.S. at 80; *see also Chicago, B. & Q. Ry.* v. *Babcock,* 204 U.S. 585 (1907); *Rowley* v. *Chicago & N.W. Ry.,* 293 U.S. 102 (1934); *Great Northern Ry.* v.

Weeks, 297 U.S. 135 (1936). And though the court below took great pains to explain why it thought *Maine* v. *Grand Trunk Ry., supra,* as amplified by *Galveston, H. & S.A. Ry.* v. *Texas,* 210 U.S. 217 (1908), demarcated clear distinctions between franchise taxes and other sorts of taxes, it failed to acknowledge this Court's observation in *Galveston* that, although a franchise or other tax "might be estimated *prima facie* by gross income computed by [a mileage allocation formula] . . . [n]either the state courts nor the legislatures, by giving the tax a particular name or by the use of some form of words, can take away the [judicial] duty to consider its nature and effect." 210 U.S. at 226-27.

This Court's recent decision in *Complete Auto Transit* v. *Brady,* 430 U.S. 274 (1977), confirms the principle that the name attached to a tax will not affect the scrutiny it receives; all taxes must be tested alike by "the question whether the tax produces a forbidden effect." Just as "privilege" taxes and "franchise" taxes cannot occupy different statuses in the eyes of the Constitution merely because of the labels attached to them, the "franchise" tax imposed by Maine "must receive the careful scrutiny of the courts" to determine its impact on interstate commerce. *Id.* at 288-89 n.15. Indeed, this Court has been especially vigilant to inquire into the application of an apportionment formula in cases where a state has claimed that its formula takes into account intangible value, going concern value, and comparable measures of value. *See, e.g., Norfolk & Western Ry.* v. *Missouri State Tax Comm'n,* 390 U.S. 317 (1968); *Union Tank Line* v. *Wright,* 249 U.S. 275 (1919); *Fargo* v. *Hart,* 193 U.S. 490 (1904).

That brings us to the other critical flaw in the Supreme Judicial Court's analysis of why a franchise tax measured by gross receipts and NROI may be apportioned differently from a tax laid directly on receipts and NROI: the court below identified no increase in the value of the franchise, or increased "intangible" value, deriving from the great majority of the per diem income earned outside Maine.[8] We have already shown that IPD income, because of the restrictions governing its use, cannot increase the "value of the franchise" until a railroad has satisfied the requirements of the federal regulations and until it has actually used the funds for the acquisition of boxcars; we have also shown how the court below was compelled to acknowledge how the impact of the restrictions and of the excise tax itself threatened appellant with having to surrender—but nonetheless to pay excise tax on—large amounts of IPD funds it may never use to increase the "value of the franchise." (Pp. 14-24, *supra.*) Under the circumstances, there can be no permissible basis for application of the mileage apportionment formula to appellant's IPD income during 1974. *Cf. Norfolk and Western Ry.* v. *Missouri Tax Comm'n, supra; Wallace* v. *Hines, supra.*

[8] IPD credit balances constituted approximately 92 percent of all per diem income earned by appellant in 1974. (R. 37.)

CONCLUSION

The decision below conflicts with the decisions of this Court. It cannot be sustained on the grounds advanced by the court below. If allowed to stand, the decision frustrates important federal policies, burdens interstate commerce, and taxes property and activity beyond the jurisdiction of the State of Maine. The Court should note probable jurisdiction and set the case for argument on the merits.

Respectfully submitted,

PETER J. NICKLES
EUGENE D. GULLAND
MARC B. TUCKER
COVINGTON & BURLING
888 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 452-6000

WILLIAM C. SMITH
JAMES G. GOOD
PIERCE, ATWOOD, SCRIBNER,
ALLEN, SMITH & LANCASTER
One Monument Square
Portland, Maine 04111
(207) 773-6411

Attorneys for Maine Central Railroad Company

Of Counsel:

SCOTT W. SCULLY
General Counsel
MAINE CENTRAL RAILROAD COMPANY
242 St. John Street
Portland, Maine 04102
(207) 773-4711

APPENDIX

Opinion of the Supreme Judicial Court of Maine

Date Opinion Filed

November 16, 1977

Reporter of Decisions
Decision No. 1555
Law Docket No. Ken-77-14

MAINE CENTRAL RAILROAD COMPANY

v.

RAYMOND L. HALPERIN, ET AL.

WERNICK, J.

On July 23, 1975 plaintiff Maine Central Railroad Company commenced a civil action in the Superior Court (Kennebec County) seeking an adjudication by declaratory judgment (14 M.R.S.A. § 5951-5963) that either (1) 36 M.R.S.A. § 2624, correctly interpreted, does not contemplate, for the purpose of the computation of Maine's excise tax on railroads, the inclusion within "net railway operating income" of "incentive per diem" charges (49 C.F.R. Part 1036, as hereinafter more fully explained); or (2) if the statute requires such inclusion, in that particular it violates the Constitution of the United States, contravening the "Supremacy" Clause of Article VI, or the "Commerce" Clause of Section 8 of Article I, or both.

Named as defendants in the action were the State Tax Assessor, Raymond L. Halperin, and the Attorney General, Joseph E. Brennan. The Interstate Commerce Commission was permitted to intervene in the action as amicus curiae. Issue was joined by an answer filed by defendants. Defendant State Tax Assessor also filed a counterclaim demanding judgment against plaintiff for balances of excise tax payments due for three quarters in 1975, in the

amounts of $205,252.93, $228,794.33 and $228,794.33 as ascertained due on June 15, September 15 and December 15, respectively, "plus interest of 10% from the due dates of the respective payments." These amounts were the total additional assessment attributable to the failure of Maine Central to include "incentive per diem" charges in its "net railway operating income" in the computation of the railroad excise tax for the year 1974.

Pursuant to Rule 72(b) M.R.Civ.P., the case has been reported to us on an agreed statement of facts for our determination of the rights of the parties.

I. The Maine Excise Tax on Railroads

Since 1881 the State of Maine has imposed upon every corporation operating a railroad in the State

> "an annual excise tax for the privilege of exercising its franchises and the franchises of its leased roads in the State." (Currently, 36 M.R.S.A. § 2623)

Presently, this annual excise tax together with the tax provided for in 36 M.R.S.A. § 561 are "in place of all taxes upon the property of such railroad." (36 M.R.S.A. § 2623)[1] The amount of the tax is equal to a percentage of the gross transportation receipts. The applicable percentage rate increases with increase in the proportion of

[1] Section 561—which together with § 2623 operates in lieu of all property taxes—provides: "The buildings of every railroad corporation or association, whether within or without the located right-of-way, its land and fixtures outside of its located right-of-way, and so much of its located right-of-way over which all railroad service has been abandoned, are subject to taxation in the places in which the same are situated, as other property is taxed therein, and shall be regarded as nonresident land." Thus, § 2623 operates as a tax upon the railroad franchise treated as property, in lieu of property tax on railroad right-of-way land and fixtures.

net railway operating income to gross transportation receipts. "Net railway operating income" is statutorily defined as

> "railway operating revenues less the railway operating expenses, . . . including in the computation thereof debits and credits arising from equipment rents . . . ." (36 M.R.S.A. § 2624)

II. Incentive Per Diem Charges

"Incentive per diem" charges went into effect in 1970 as part of the federal government's continuing efforts to remedy a chronic shortage of railroad freight cars. The history leading to this resort to incentive per diem charges will assist understanding of the relationship between them and the Maine excise tax on railroads.

The practice of interchanging railroad freight cars instead of transferring loads at the end of each railroad's line became a requirement of law with the enactment of the Interstate Commerce Act in 1887. The result was that the freight cars of the nation "became in essence a single common pool, used by all roads", *United States* v. *Allegheny-Ludlum Steel Corp.,* 406 U.S. 742, 743, 92 S.Ct. 1941, 32 L.Ed.2d 453 (1972), and each railroad boxcar owner was paid rent for the use of its cars by another railroad.

Because a critical boxcar shortage developed during World War I, Congress enacted the "Esch Car Service Act" of 1917, 40 Stat. 101, 49 U.S.C. § 1(14)(a). It empowered the Interstate Commerce Commission to establish per diem rental charges as *compensatory* charges; they presently consist of mileage and per diem rates varying with the cost and age of the boxcar. As regular rental charges, these per diem rates provide revenue which the collecting railroad may utilize for its expenses and general corporate purposes.

In 1966, confronting a persisting nation-wide boxcar shortage, Congress amended the Interstate Commerce Act to authorize the Commission to prescribe additional charges embodying such *incentive element as will*

> ". . . in the judgment of the Commission, provide just and reasonable compensation to freight car owners, contribute to sound car service practices (including efficient utilization and distribution of cars), and encourage the acquisition and maintenance of a car supply adequate to meet the needs of commerce and the national defense." [2]

By comprehensive regulations [3] the Commission thereafter established "incentive per diem" charges: charges over and above the basic compensatory rental charges applicable to general service unequipped boxcars in the possession of non-owning railroads. As revenues received for car hire in excess of the costs or risks of ownership, the incentive per diem charges are intended to encourage railroads to acquire and maintain an adequate supply of freight cars.

Further to assist in this purpose, the regulations specifically restrict a railroad's use of incentive per diem income to the purchasing, building, rebuilding, or leasing of boxcars and to the payment of state and federal *income* taxes attributable to incentive per diem income. With the

[2] Section 1 (14)(a), as amended by P.L. 89-430, 80 Stat. 168 (1966) and re-enacted by P.L. 94-210, 90 Stat. 46-47 (1976).

[3] The regulations, originally set forth in Incentive Per Diem Charges—1968, Ex Parte No. 252 (Sub. No. 1), 337 I.C.C. 183 (1969), now codified at 49 C.F.R. Part 1036, have been sustained by the Courts, *United States* v. *Florida East Coast Ry. Co.*, 410 U.S. 224, 93 S.Ct. 810, 35 L.Ed.2d 223 (1973), on remand, 368 F. Supp. 1009 (M.D. Fla. 1973), aff'd per curiam, 417 U.S. 901 (1974), and thus are deemed to have the force of law. *Public Utilities Commission of California* v. *United States*, 355 U.S. 534, 542, 78 S.Ct. 446, 2 L.Ed.2d 470 (1958).

funds derived from incentive per diem charges thus earmarked and segregated, they are not available as general corporate funds from which the railroad can pay its liabilities, such as Maine's excise tax on railroads.[4]

After expenditure by a railroad of the incentive per diem funds, the boxcars so acquired become part of the railroad's general assets:—that is, earmarking of the incentive per diem funds restricts the railroad only up to and including the point of expenditure; thereafter the railroad owns the boxcars outright, even though the financial source represents revenue in excess of the ordinary rate of return.

The incentive per diem charge funds collected by the railroad must either be put to the intended use within eighteen months or be voluntarily surrendered to "Rail Box", a corporation approved by the Interstate Commerce Commission and organized to acquire, own and lease a fleet of boxcars for use as a national boxcar pool. If a railroad which has not made timely use of the incentive funds fails to surrender them to Rail Box, the railroad becomes subject to investigation by the Interstate Commerce Commission.

III. Inclusion of Incentive Per Diem Charges in Net Railway Operating Income

As a threshold issue, we are asked to decide whether the concept of "net railway operating income," as statutorily defined, requires the inclusion of incentive per diem charges in the computation of the Maine excise tax on railroads.

[4] In addition, each carrier must acquire its "test period quota" of boxcars each year with general corporate funds before expending any incentive per diem funds. The quota, designed to prevent use of incentive funds for the ordinary purchase of car replacements, requires the railroad to purchase its annual average number of cars purchased, built or rebuilt in the five-year period from 1964 to 1968.

Maine Central contends that such inclusion of incentive per diem charges would be contrary to the Legislature's purpose in adopting the current definition of net railway operating income. As support for this position, Maine Central relies on the Legislature's adoption of the gross-net method of taxation in 1927, which, says Maine Central, reflects legislative intent that the excise tax be based strictly on the railroad's *ability-to-pay*. Maine Central argues that because the earmarking of the incentive per diem funds precludes use of the funds for general corporate purposes, such as payment of the railroad excise tax, inclusion of the restricted incentive per diem funds in the tax computation would increase the tax burden on general corporate assets and therefore is not consonant with the legislative approach predicated on *ability-to-pay*.

The argument is unconvincing.

As the excise tax on railroads was originally enacted in 1881 (P.L. 1881, Ch. 91), the rate of the excise tax increased with increase in the average gross transportation receipts per mile of track, and the amount of the tax was determined by multiplying the gross transportation receipts earned within the State by the tax rate. This led to the asserted inequity that even though a railroad continued to own substantially the same amount of property, it would nevertheless be liable for an increased amount of excise tax—as a function of the increased revenues deriving from increases in rate charges necessitated by higher operational expenses. These allegedly excessive tax burdens arose "not by reason of any increased prosperity" but rather as a result of increased revenues allowed by the Interstate Commerce Commission to defray corresponding increases in the costs of operation. See: Remarks of Representative Merrill, Legislative Record at 597, 83rd Maine Legislature (1927).

As a response to such inequities, the Legislature in 1927 adopted the current "gross-net method" (P.L. 1927, Ch. 27) under which the excise tax continues to be measured

by gross transportation receipts, but the rate of the tax is made to depend on the ratio of net railway operating income to gross transportation receipts.

Maine Central's claim is that inclusion of incentive per diem charges in the computation of net railway operating income would re-introduce the "mischief" which it was the Legislature's purpose to eliminate by the 1927 adoption of the gross-net method of excise taxation.

We cannot agree.

The function of the excise tax on railroads is to measure and tax the value of a railroad's franchise. Yet, pursuant to the approach prior to 1927, taxes resulted from correlative increases in expenses and rates without a corresponding increase in the prosperity of the railroad. Thus, taxes flowed from a distorted measurement of the value of the railroad franchise, and this was the "mischief" purported to be remedied by the Legislature's 1927 adoption of the gross-net methodology.

Such mischief—a distorted measurement of the value of the railroad franchise—does not result from including incentive per diem charges in net railway operating income. Although the excise tax burden enters as a cost factor, incentive per diem income constitutes a real addition to the operating income and prosperity of the railroad. Accordingly, insofar as the excise tax operates to measure and to tax the value of the railroad franchise, it is appropriate that the real increase in the value of the franchise occurring by virtue of the incentive per diem funds should be reflected in the railroad's excise tax liability—through the imposition of a higher tax rate on gross transportation receipts.

Maine Central errs, therefore, in characterizing the introduction in 1928 (in consequence of 1927 legislation) of the definition of net railway operating income as indicative of a legislative undertaking to build an *ability-to-pay*

mechanism into the excise tax. Proceeding from this error, Maine Central perpetrates the further error of inaccurately asserting that the inclusion in net railway operating income of per diem incentive revenues, which are not available for payment of general corporate expenses such as the excise tax, defeats the legislative objective that net railway operating income should provide the measure of a railroad's ability to pay the excise tax.

Maine Central also argues that the incentive per diem balances do not increase the profitability of the railroad collecting them because the incentive funds are "trust" monies. This is a loose use of the "trust" concept which confuses, rather than assists, correct analysis of the issue before us. It conceals the reality that the incentive per diem revenues do increase the total profit and value of creditor railroads to the extent that the incentive charges represent "compensation above and beyond the base costs of freight car ownership." *Illinois Terminal R.R. Co.* v. *United States*, 541 F.2d 201 (8th Cir. 1976) As revenue in excess of a fair rate of return, the incentive per diem charges enable a creditor railroad to receive an additional return on its current investments in cars in use on other lines without the burden of additional costs. True, the earmarking of funds for use to purchase, build, rebuild or lease unequipped general service boxcars might be some indication of a "trust" relationship. Yet, it is a strong indication to the contrary that the owning railroad is the primary beneficiary of the charges. For example, once the earmarked funds have been expended, plainly any "trust" status is lost; the cars become the outright property of the railroad. In addition, the new cars earn more mileage, as well as ordinary and incentive per diem revenues, and function as cost free additions to the railroad's hauling capacity.

In light of the history and purpose of the Maine Legislature's 1927 amendment, then, we conclude that the correct interpretation of 36 M.R.S.A. § 2624 is that, within the

Legislature's intendment, "net railway operating income" includes incentive per diem funds. This conclusion also finds support in the statutory language defining net railway operating income as "including in the computation thereof debits and credits arising from equipment rents." We see no reasonable alternative to holding that incentive per diem income constitutes a "credit" to a railroad arising from the equipment rent of its general service railroad boxcars.

IV. Application of the Supremacy Clause

Having arrived at the statutory interpretation that net railway operating income includes incentive per diem charges for the purpose of the computation of the Maine excise tax on railroads, we turn to the question whether in this particular facet the statute becomes unconstitutional as violative of the Supremacy Clause of Article VI of the Constitution of the United States.[5]

Neither the Congress itself nor the Interstate Commerce Commission acting within the powers conferred upon it by Congress has expressly prohibited the State of Maine from requiring, for the purposes of computing the Maine excise tax on railroads, that the revenues from incentive per diem charges be included in net railway operating income. Hence, Maine Central's invoking the Supramacy Clause to prohibit such exercise of Maine's power of taxation must be taken as a claim that such result is mandated, here, by implication from the existence of the federal program in which incentive per diem charges serve an important function.

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[5] The Supremacy Clause reads:

"This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

When the existence of a federal undertaking is thus asserted to deny, by implication, a State's exercise of powers normally possessed by it, the analysis becomes complex because of the relativity of the values at stake and the lack of any single generalized guiding principle. In *Hines v. Davidowitz,* 312 U.S. 52, 67, 61 S.Ct. 399, 85 L.Ed. 581 (1941) the Court said:

> "There is not—and from the very nature of the problem there cannot be—any rigid formula or rule which can be used as a universal pattern . . . . This Court, in considering the validity of state laws in the light of treaties or federal laws touching the same subject, has made use of the following expressions: conflicting; contrary to; occupying the field; repugnance; difference; irreconcilability; inconsistency; violation; curtailment; and interference. But none of these expressions provides an infallible constitutional test or an exclusive constitutional yardstick. In the final analysis, there can be no one crystal clear distinctly marked formula."

With reference specifically to a claim that the Supremacy Clause mandates a denial in particular respects of a State's exercise of its power of taxation, the Court in *Penn Dairies v. Milk Control Commission of Pennsylvania,* 318 U.S. 261, 270-271, 63 S.Ct. 617, 87 L.Ed. 748 (1943) stressed the primacy of state taxing powers, asserting that the federal Constitution

> ". . . presupposes the continued existence of the states functioning in coordination with the national government, with authority in the states to lay taxes . . . ."

Further, in *Hines v. Davidowitz, supra,* the Court indicated that there must be greater play for the concurrent exercise by a state of such of its power as is "bottomed on the . . . broad base . . . [of] its power to tax." (312 U.S. at 68)

When therefore the claim is, as here, that the existence of a federal program impliedly demands an abridgment of Maine's exercise of its taxing power, the caveat of the Supreme Court of the United States in *Penn Dairies v. Milk Control Commission of Pennsylvania,* supra, has cogent applicability:

> "[W]e should be slow to strike down legislation which the state concededly has power to enact, because of its asserted burden on the federal government. For the state is powerless to remove the ill effects of . . . [such] decision, while the national government which has the ultimate power, remains free to remove the burden." (318 U.S. at 275)

With this word of caution in mind we note, initially, that Maine's imposition of an excise tax on the value of a railroad franchise does not inherently, or necessarily, destroy, or directly conflict with, the federal incentive program and its purpose to alleviate the shortage in the national supply of boxcars. Seemingly acknowledging this point, Maine Central concentrates on the particular feature that Maine includes incentive per diem charges in net railway operating income, as an incident of the methodology by which the Maine excise tax on railroads is computed. It is this special factor, Maine Central argues, which creates serious potential for frustration of the federal incentive program.

We disagree.

Viewing the matter, first, relative to potential impact upon Maine Central as one individual railroad, we believe that despite Maine's inclusion of incentive per diem charges in net railway operating income, Maine Central will continue to have strong incentives to acquire additional boxcars with the use of its per diem incentive funds. Since the incentive per diem charges are charges in excess of the ordinary rate of return, the incentive funds increase the value of the franchise and produce an additional hauling capacity which, upon expenditure of the funds, becomes the

outright property of the railroad. The expenditure of incentive funds yields a further benefit to the railroad because the resulting additional car supply earns more mileage and ordinary per diem rates, as well as incentive per diem charges. By acquisition and expenditure of additional incentive funds, the railroad increases both its value and profitability.[6] The burden of excise tax would have to reach very substantial proportions before Maine Central would find it necessary to forego the cost-free benefits of the incentive charges.

In large part Maine Central's argument to show "disincentive" consequences rests on a unique combination of circumstances which happened to result in 1974 in an imposition of the excise tax at a rate higher than the minimum rate. However, because incentive per diem charges as such are not taxed by the excise tax but, rather, are merely included in the computation by which the applicable rate becomes determined, an increase of incentive funds need not necessarily produce a greater excise tax liability. For example, in the years 1970 to 1973 the amount of Maine Central's excise tax liability to the State of Maine would not have changed if the incentive per diem charges had been excluded from net railway operating income. The year 1974 was unusual. Because Maine Central's earnings were the highest in its 112 year history, the excise tax rate increased from the minimum rate of 3¼% of the gross transportation receipts to the next level rate of 3¾%. For 1975, Maine Central's tax returned to the minimum rate.[7]

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[6] In 1974, for example, Maine Central's boxcars earned an average of $737 per general service unequipped boxcar, which resulted in an additional excise tax of $197 per general service unequipped boxcar.

[7] The rates are as follows: 3¼% when NROI (net railroad operating income) does not exceed 10% of GTR (gross transportation receipts); 3¾% when NROI is between 10 and 15% of GTR; 4¼% when NROI is between 15 and 20% of GTR; 4¾% when NROI is between 20 and 25% of GTR; and 5¼% when NROI exceeds 25% of GTR.

Maine Central's excise tax rate for 1974 also happened to reflect the special fact that there was at that time a higher rate of incentive per diem charges authorized by the Interstate Comerce Commission. As originally promulgated, incentive charges were imposed on a 6 month basis from September to February each year. Effective May 1, 1973, during the Russian wheat sales, the Commission extended the incentive charges to a year round basis. As based on these rates, therefore, the additional incentive per diem charges, representing a return beyond the 6% ordinary rate of return, equalled 6% annually from 1970 to 1972, approximately 10% in 1973, 12% in 1974 and 1975, and 6% thereafter. See: Incentive Per Diem Charges—1968, 337 I.C.C. 217, 225, 246 (1970) and Incentive Per Diem Charges—1968, 350 I.C.C. 473 (1975). Since the Commission indefinitely cut incentive charges in half (back to 6%) effective September 15, 1975, it would appear for the future that Maine Central can continue to acquire and expend greater amounts of incentive funds without exceeding the minimum rate of taxation, at least in the absence of another record breaking year of income earnings.[8]

Maine Central argues that the inclusion of incentive per diem charges within net railway operating income will frustrate the federal incentive program because it will

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[8] The ICC eliminated year round application of the incentive, believing that continuation could not "be justified because of the present surplus of unequipped general service boxcars." The Commission continued the 6 month rate, however, deeming the supply of boxcars still inadequate because of the decline in their ownership and the temporary decline in demand.

Maine Central also argues that it had insufficient funds in 1975 with which to pay the tax imposed for 1974. This difficulty merely reflects inadequate planning by the railroad. Maine Central's 1974 balance reflects $1,004,105 in unrestricted ordinary income available for general corporate purposes and expenses, including payment of the additional $615,000 in excise tax. In addition, other funds available for payment of the excise tax included $3,569,207 in extraordinary income from the sale of the Mattawamkeag to Vanceboro line in 1974.

result in an excise tax burden on general corporate assets likely to leave insufficient general funds from which Maine Central can meet the basic test period quota (discussed in n.4, supra)—a quota which the railroad must acquire with general assets before it may utilize the segregated incentive funds. In addition to doubts we entertain that the test period quota has the severity Maine Central purports to attribute to it,[9] we believe that appropriate use of its financial planning resources will enable Maine Central readily to compute the level at which generation of additional incentive charges will excessively burden general corporate assets.

While there could be a point at which, because of an unlimited increase in incentive funds, the excise tax burden on general corporate funds could be so heavy as to eliminate further incentive for, or ability of, an *individual* railroad to acquire additional boxcars, this cannot be dispositive in the determination of whether the *national* incentive program will be frustrated. Indeed, it is an infirmity of Maine Central's argument that it would relate the incentive program *exclusively* to the resulting financial impact on an individual railroad and its financial incentive to acquire additional boxcars. Maine Central thus ignores the underlying nature and purpose of the federal boxcar program. Acquisition of additional boxcars by *individual* owning railroads represents only one alternative mechanism for the achievement of the federal goal of an adequate *national* supply of boxcars. Even on the assumption that the excise tax could produce adverse consequences for Maine Central which might destroy incentive for Maine Central to acquire additional boxcars, the federal regulations still require that every dollar of incentive per diem funds available after income tax payments be spent on the acquisition and maintenance of additional boxcars. The

[9] See: The Freight Car Shortage and ICC Regulation, 85 Harv. L. Rev. 1583 (1972).

ICC regulations specifically anticipate, and deal with the prospect, that individual railroads will refuse to spend incentive funds on additional boxcars. In such situation the regulations approve, and by imposition of certain investigative procedures mandate, the transfer of unused earmarked incentive funds to Rail Box. 49 C.F.R. § 1036.4. Thus, the existence of Rail Box, as a corporation organized to acquire, own and lease a fleet of boxcars, guarantees expenditure of the federal incentive funds without the danger of frustration of the *national* program by the actions of *individual* railroads.[10]

The underlying fallacy of Maine Central's argument is that it assumes as realistic financial possibilities only those lying at the two end-poles of a continuum of financial possibilities. Maine Central projects that either (1) incremental increases in the excise tax rate will destroy *all incentive* of a railroad to acquire additional boxcars; or (2) at the opposite pole, the incentive funds generated by the railroad will be of so great a magnitude that the resulting increase in the level of excise tax liability will destroy *the ability* of the railroad to meet its basic acquisition quota from its general funds.

[10] The overall scheme of the federal incentive charge program indicates its purpose to increase the national supply of boxcars without regard to distribution of ownership by *individual* railroads. (In fact, railroads which do not own boxcars receive no help by the incentive program; only owning railroads receive additional revenue from the incentive charges). Since the boxcar shortage arose as a result of the interchange of railroad freight cars at the end of each railroad's line, the incentive program, to the extent it relies on acquisition of additional boxcars by individual railroads, will be successful only so long as the incentive charges remain in effect. In contrast, acquisition of additional boxcars by Rail Box, as a corporation dedicated solely to the acquisition and maintenance of an adequate supply of boxcars, may in fact improve the supply and efficiency of the boxcar pool by direct recognition of the existence of a "national pool of boxcars."

We are not persuaded by this analysis because we find it artificially extreme. It overlooks the reality that railroads engage in financial planning and can devise strategies, in relation to possible excise tax liabilities, which will tend to prevent the occurrence of the above-described extreme situations. Through planning railroads can place themselves in intermediate financial postures tending to protect general corporate assets while simultaneously permitting enjoyment of the benefits to be derived from participation in the federal boxcar incentive program.[11]

The existence, and functioning, of Rail Box further indicates that the manner of Maine's imposition of its excise tax on railroads need not unduly interfere with the federal program of generating a nation-wide acquisition of a substantial number of additional boxcars. In the circumstances when the tax might begin to operate as a disincentive to certain marginal or incremental additional boxcar acquisitions, the requirement for surrender of the funds to Rail Box will work toward achieving complete expenditure of the funds, thus to produce an optimal increase in the national supply of boxcars.

On the basis of the foregoing analysis we are satisfied that Maine's inclusion of incentive per diem charges in net railway operating income, for the computation of the Maine excise tax on railroads, has no direct, generalized tendency to affect the federal boxcar incentive program

[11] The agreed statement of facts contains the depositions of two witnesses, the President of Maine Central and a Cost Analyst of the ICC. The parties agreed that the testimony contained in the depositions is the testimony that the witnesses "would give . . . if under oath and present and testifying." Both witnesses suggested that inclusion of the incentive funds in the computation of the Maine excise tax would create an adverse impact on the federal incentive program. However, we are free to evaluate and to disregard the testimony and conclusions of these witnesses and to draw such factual inferences and legal conclusions as warranted by the report of the entire case to this Court.

so adversely as to require, by force of the Supremacy Clause of the Constitution of the United States, the nullification of that particular exercise of Maine's power of taxation *by implication* from the existence, and needs, of the Federal program.[12]

V. The Commerce Clause

As an alternative constitutional attack, Maine Central maintains that the formula for apportionment of net railway operating income, as applied when incentive per diem charges are included in net railway operating income, becomes violative of the Commerce Clause (Section 8 of Article I) of the Constitution of the United States.

[12] The ICC regulations allowing payment of income taxes attributable to the incentive charges do not require a contrary result. While the ICC's allowing payment of income tax from the restricted funds may evidence intent to prevent imposition of additional income tax burden on general corporate funds as a result of the incentive charges, it nevertheless also indicates that such tax burdens as flow from an income tax on the restricted funds are not deemed to impair the federal program. In similar vein, the ICC could see fit to allow a deduction from the incentive fund for the payment of State excise taxes. That the ICC has not yet seen fit to allow any such deductions or payment from the restricted incentive funds suggests to us, objectively, that any other liabilities resulting from the incentive fund are deemed to be an acceptable burden on general corporate funds. In fact, in a 1973 report on the incentive program, the ICC expressly recognized that the incentive funds would create certain liabilities on the railroad corporation for which no general funds existed, and that this would not frustrate the federal incentive program. In response to a question concerning a carrier which became liable for payment of contingent interest and bond sinking fund contributions, because of bond indenture requirements resulting from inclusion of incentive per diem in an ordinary income, the ICC answered:

> "Regardless of the fact that by including incentive per diem in ordinary income an interest liability is created for which there are no funds available, current accounting rules require that all car per diem income must be recorded in the ordinary income account." See: Incentive Per Diem Charges—1968, 343 I.C.C. 55 (1973) (informal answer to question 8).

To avoid violation of the Commerce Clause, in general, the Maine railroad excise tax utilizes an apportionment formula to determine the in-state elements of the gross transportation receipts and net railway operating income of the railroads engaged in interstate operations. The formula is stated as follows:

> "The gross transportation receipts of such [an interstate] railroad, line or system, as the case may be, over its whole extent, within and without the State, shall be divided by the total number of miles operated to obtain the average gross transportation receipts per mile, and the gross transportation receipts in the State shall be taken to be the average gross transportation receipts per mile multiplied by the number of miles operated within the State, and the net railway operating income within the State shall be similarly determined." (36 M.R.S.A. § 2624)

Maine Central's contention is that this formula, regardless of whether it may generally operate to protect against Commerce Clause violation, produces a contravention of the Commerce Clause in the particular circumstances, as here, in which incentive per diem charges are included in net railway operating income for purposes of computing the railroad excise tax. Maine Central points out that 765 miles of its total of 908 miles of track are located in Maine. In light of this fact the inclusion of incentive per diem charges in net railway operating income produces the result, says Maine Central, that application of the apportionment formula attributes to the State of Maine 84.25% of the net freight car rental charges and net incentive per diem charges even though, in 1974, less than 3% of Maine Central's freight car rental charges and incentive per diem charges came from boxcar rentals *within* Maine.

The cases of *Central Greyhound Lines, Inc.* v. *Mealey,* 334 U.S. 653, 662-663, 68 S.Ct. 1260, 92 L.Ed. 1633, 1641 (1948) and *Gwin, White & Prince, Inc.* v. *Henneford,* 305

U.S. 434, 59 S.Ct. 325, 83 L.Ed. 272 (1939) on which Maine Central relies to support its argument are distinguishable. These cases stand for the proposition that an *unapportioned* tax on, or measured by, the gross receipts of an interstate corporation violates the Commerce Clause. But the tax here is not *unapportioned;* an apportionment formula is utilized. Maine Central's claim is that the formula results in improper apportionment allocations. However, that a formula may produce a mathematically inexact apportionment does not per se establish a violation of the Commerce Clause; rough approximation, as a practical matter, is the norm of any state taxation system. *Illinois Central R.R. Co.* v. *Minnesota,* 309 U.S. 157, 161, 60 S.Ct. 419, 84 L.Ed. 670 (1940). In addition, the party attacking the apportionment formula carries the distinct burden of proving by "clear and cogent evidence" that it results in taxation of extraterritorial values. *Butler Brothers* v. *McColgum,* 315 U.S. 501, 507, 62 S.Ct. 701, 86 L.Ed. 991 (1942). Indeed, as further explained in *Central Greyhound Lines, Inc.* v. *Mealey,* supra, one of the primary cases on which Maine Central relies,

> "[T]he tax may constitutionally be sustained on the receipts from the transportation apportioned as to the mileage within the State." (334 U.S. at 663)

See also: *Canton R.R. Co.* v. *Rogan,* 340 U.S. 511, 515-516, 71 S.Ct. 447, 95 L.Ed. 448 (1951) (approval of railroad mileage apportionment formula).

A prior version of the present Maine excise tax was sustained by the United States Supreme Court over a Commerce Clause attack in *Maine* v. *Grand Trunk Railway Co.,* 142 U.S. 217, 12 S.Ct. 121, 35 L.Ed. 994 (1891). *Grand Trunk,* an authority not challenged by Maine Central, upheld the 1881 version of the excise tax which imposed a franchise tax measured solely by the gross receipts of the railroad and apportioned by a mileage for-

mula almost identical to that of the present tax. We understand Maine Central to be claiming here, that *Grand Trunk* loses its precedential force in the face of the allegedly distinguishing circumstance that incentive per diem charges are made an additional element of net railway operating income for purposes of computation of the rate of excise tax.

In our view, however, *Grand Trunk* becomes distinguishable neither in result nor rationale by the presence of this additional factor. *Grand Trunk* carefully explained that the Maine tax was apportioned according to the *value of the railroad franchise.* The levy was not on gross transportation receipts; rather, gross transportation receipts constituted the means of ascertaining the value of the privileges conferred. 142 U.S. at 228, 230. As subsequently explained in *Galveston, Harrisburg & San Antonio Ry. Co.* v. *Texas,* 210 U.S. 217, 28 S.Ct. 638, 52 L.Ed. 1031 (1908), the Maine statute, significantly, taxed only the value of the franchise, and this was taxed as property in lieu of certain local ad valorem property taxes rather than as receipts of transportation. Characterizing the systemic scheme of the Maine excise tax on railroads, the *Galveston* Court said:

> "The buildings of the railroad and its lands and fixtures outside of its right of way were to be taxed locally, as other property was taxed, and this excise with the local tax were to be in lieu of all taxes. The language shows that the local tax was not expected to include the additional value gained by the property being part of a going concern. . . . The excise was an attempt to reach that additional value." (210 U.S. at 226)

It is of prime importance here, then, that the present excise tax continues the identical scheme embodied in the 1881 statute, by operating in lieu of local property taxes on the value of the franchise. See also: *Railway Express*

Agency, Inc. v. *Virginia,* 358 U.S. 434, 444, 79 S.Ct. 411, 3 L.Ed.2d 450 (1959); *Illinois Central R.R. Co.* v. *Minnesota,* 309 U.S. 157, 60 S.Ct. 419, 84 L.Ed. 670 (1940); *Cudahy Packing Co.* v. *Minnesota,* 246 U.S. 450, 38 S.Ct. 373, 62 L.Ed. 827 (1918); and *United States Express Co.* v. *Minnesota,* 223 U.S. 335, 32 S.Ct. 211, 56 L.Ed. 459 (1912). As the *Galveston* case, supra, explained, the validity of a franchise tax, insofar as it is a tax upon the property value of the railroad's franchise as augmented by the value of the railroad's interstate commerce, depends on consideration of the value of the *entire franchise* including therein its interstate operations; and the resort to trackage as the basis on which the apportionment formula rests may be taken as "a measure of *the value of the property* per mile." (emphasis supplied) (210 U.S. at 226) [13] We find unpersuasive, therefore, Maine Central's argument that the validity of the apportionment formula, as here applied, is to be assessed by considering income from freight rentals *in isolation from the totality* of the railroad's operating income.

The 1927 addition of net railway operating income as a factor in the rate computation modifies the tax in a manner solidifying its status as a franchise tax. A tax measured in part by net income more accurately reflects the value of the franchise than a tax measured solely by gross receipts. See: *United States Glue Co.* v. *Oak Creek,* 247 U.S. 321, 38 S.Ct. 499, 62 L.Ed. 1135 (1918). Accordingly, the 1927 amendment presently in effect insulates the

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[13] *Galveston* stressed that the State has the right to tax the franchise, as property, "at its actual value *as a going concern.*" (emphasis supplied) (210 U.S. at 227) Further explaining, the Court said: "As the property of companies engaged in such commerce . . . may be taxed at its value as it is, in its organic relations, and not merely as a congeries of unrelated items, taxes on such property have been sustained that took account of the augmentation of value from the commerce in which it was engaged." (210 U.S. at 225)

tax, even beyond the protection afforded by the approval in *Grand Trunk,* from attack as a gross receipts tax on interstate commerce.

> "The Court long since ha[s] recognized that interstate commerce may be made to pay its way." *Complete Auto Transit, Inc.* v. *Brady,* ——U.S.——, 97 S.Ct. ——, 51 L.Ed.2d 326, 334 (1977)

The inclusion of per diem incentive charges in net railway operating income does not cause a malapportionment violative of the Commerce Clause of the Constitution of the United States.

VI. The Counterclaim of Defendant

Plaintiff's reply to defendant's counterclaim raises no issues beyond those above considered. The effect of the pleadings is thus to establish that in the event this Court should rule against plaintiff Maine Central on its statutory interpretation and constitutional contentions, as the Court has herein ruled, plaintiff concedes its liability for the 1974 railroad excise tax in the amounts asserted in the counterclaim of defendant State Tax Assessor.

The entry is:

(1) It is adjudicated: (a) correctly interpreted, 36 M.R.S.A. § 2624 requires for purposes of the computation of the Maine excise tax on railroads, that incentive per diem charges be included in net railway operating income; (b) thus interpreted, 36 M.R.S.A. § 2624 violates neither the Supremacy Clause of Article VI nor the Commerce Clause (Section 8 of Article I) of the Constitution of the United States;

(2) the case is remanded to the Superior Court with directions that said Court order (a) as to plaintiff's complaint, that judgment be entered in favor of the defendants; and (b) as to the counterclaim of defendant State Tax Assessor, that judgment be entered for defendant State Tax Assessor in the amounts sought by the counterclaim.

Pomeroy, J., did not sit.

Dufresne, A.R.J. sat at oral argument as Chief Justice, but retired prior to the preparation of the opinion. He has joined the opinion as Active Retired Justice.

Wernick, Archibald, Delahanty, Godfrey J. J. and Dufresne, A. R. J. Concurring.

Attorneys for the Plaintiff:
Pierce, Atwood, Scribner,
Allen, Smith & Lancaster
By: William C. Smith, Esq.
James G. Good, Esq.
One Monument Square
Portland, Maine 04111

Attorneys for the
Defendants:
Clifford B. Olson, Esq.
Jerome S. Matus, Esq.
Assistant Attorneys General
Bureau of Taxation
State House
Augusta, Maine 04333

Henri Francis Rush, Esq.
Alan W. Heifetz, Esq.
Interstate Commerce
Commission
Office of the General Counsel
Washington, D.C. 20423
(Amicus Curiae)

Opinion of the Supreme Judicial Court of Maine on Reconsideration

Reporter of Decisions
Decision No. 1584
Law Docket No. Ken-77-14

Date Opinion Filed
December 27, 1977

MAINE CENTRAL RAILROAD COMPANY

v.

RAYMOND L. HALPERIN, et al

WERNICK, J.

On motion for reconsideration.

Plaintiff Maine Central has moved for reconsideration of the Court's November 16, 1977 opinion in this case. Maine Central's motion asks us to address the issue

> "whether the imposition of the Maine Railroad Excise Tax under the specific circumstances affecting Maine Central's 'net railway operating income' in 1974 contravened the Commerce [Clause] . . . ."

Maine Central suggests that this question became obscured, inadvertently, in the attention concentrated on the broader argument that it is facially unconstitutional to include incentive per diem income in the "net railway operating income" used to compute the excise tax on railroads. Although we are satisfied that in its fundamental import our original opinion sufficiently covered the "as applied" issue now being raised, in the interest of full clarity we deem it appropriate to add a clarifying supplement. It is true that in our original opinion we gave extensive consideration to the "unique combination of circumstances" which occurred in 1974 in arriving at our decision reviewing Maine Central's challenge predi-

cated on the Supremacy Clause of the Constitution of the United States, a decision which Maine Central has not asked us to reconsider.[1] We did not, however, ignore the 1974 circumstances in addressing the Commerce Clause question. On that issue the purport of our decision was that even in relation to the special circumstances of 1974, the application of the mileage apportionment formula to net railway operating income did not contravene the Commerce Clause.

In Part II of its motion Maine Central relies on *Norfolk & Western Ry. Co.* v. *Missouri State Tax Commission,* 390 U.S. 317 (1968) to support the contention that the excise tax as applied in 1974 violated the Commerce Clause. In the *Norfolk* case, the Supreme Court ruled that

> "when a taxpayer comes forward with strong evidence tending to prove that the mileage formula will yield a grossly distorted result in its particular case, the State is obligated to counter that evidence or to make the accommodations necessary to assure that its taxing power is confined to its constitutional limits. If it fails to do so and if the record shows that the taxpayer has sustained the burden of proof to show that the tax is so excessive as to burden interstate commerce, the taxpayer must prevail." (p. 329)

We reiterate our original conclusion that the taxpayer has not met its burden of proving that the mileage formula will yield a "grossly distorted" result.

The alleged "evidence" of distortion is that in the special 1974 situation the effect of the imposition of the

[1] Our original opinion ruled that the Maine Excise Tax even as applied to Maine Central in 1974 would not frustrate the incentive of Maine Central to participate extensively in the federal program and that any disincentives created by the tax would be overcome by the expenditure of the incentive funds by Rail Box in furtherance of the federal purpose of increasing the national supply of railroad boxcars.

Maine excise tax was to attribute to the State of Maine 84.25% of Maine Central's net freight car rental and incentive per diem charges when in fact only 2.62% of these receipts had been earned as the rentals from cars used in Maine. The error of this approach lies in the error of its premise, that each component of the value of the railroad franchise may be broken down and examined separately to determine whether the tax is properly apportioned as to that particular component of the value of the railroad franchise.

In this regard, contrary to Maine Central's contention, the distinction between the Maine Excise Tax on Railroads and a tax such as the ad valorem tax in *Norfolk & Western,* supra, becomes of primary importance. In *Norfolk & Western,* Missouri had imposed an ad valorem tax on "all real property . . . [and] tangible personal property" owned, hired or leased by any railroad company "in this state." Application of Missouri's mileage apportionment formula to a foreign railroad corporation resulted in a determination that 8% of the railroad's rolling stock was located in Missouri. Direct evidence, however, established that on tax day (and generally throughout the year in approximately the same proportions) only 2.71% of the total fleet of rolling stock was located in Missouri. The *Norfolk* Court rejected Missouri's attempt to uphold the tax on the basis of the enhancement or augmentation in value of the *tangible* property produced by its connection with, and organic relation to, the integrated railroad system. The tax was thus held to violate the Commerce Clause because it was imposed on tangible property not located in the state. In the instant case, in contrast, the tax does not fall on property outside of the state but rather is imposed on the value of the local railroad franchise as apportioned and measured by net railway operating income and gross transportation receipts throughout the entire railroad system.

In an ad valorem tax system, although the augmentation in value attributed to the existence of tangible property as part of a going concern is a relevant factor in valuing the individual units of tangible property located in the state, the validity of the apportionment may be broken down to individual units such as the value of the rolling stock and the value of terminal facilities. However, as we pointed out in our original opinion, the apportionment of an excise tax on a railroad franchise presents a distinguishable situation. The excise tax is imposed on the value of the local franchise valued as a going concern "in its organic relations, and not merely as a congeries of unrelated items . . .." (*Galveston* cited in n. 13). In short, with respect to the apportionment of an excise tax, it is improper to consider the validity of the apportionment as it relates to component parts of the value of the railroad franchise such as rental and incentive per diem income because the tax is not imposed on those items. Instead, a proper evaluation of the apportionment formula requires valuation of the entire franchise as a going concern. The difference in the method of apportionment results from the subject of the tax. An ad valorem tax is imposed on tangible property; the percentage attributable to each state and the value of that property even as a part of a unitary system can largely be determined separately for each individual type of property. The property value of the railroad franchise, however, can only be determined as a whole by looking first to the entire franchise and then attempting to apportion to the taxing state a fair share of that value.

Although we recognize that *Complete Auto Transit Inc. v. Brady,* —— U.S. —— (1977) abrogated artificial distinctions between a "privilege" and a "franchise" tax, we believe that here the distinction between a franchise tax and an income or ad valorem property tax retains significant substantive meaning in relation to the appropriate method of valuation and apportionment. Hence, we re-

iterate the conclusion of our original opinion, that we find unpersuasive Maine Central's argument that the validity of the apportionment formula, as here applied, is to be assessed by considering income from freight rentals in isolation from the totality of the railroad's operating income.

We do not forget that in the valuation of the local franchise of a railroad corporation the railroad's property located in another state can be taken into account only if

> "it can be seen in some plain and fairly intelligible way that it adds to the value of the road and the rights exercised in the State." *Wallace* v. *Hines,* 253 U.S. 66, 69 (1920) [2]

The basic rental and incentive charges here clearly add to the value of the railroad franchise in the State of incorporation and the major place of doing business. Because the interchange of railroad boxcars is mandatory, the value of the local railroad franchise is not limited to the value of property and privileges located at the situs of the railroad's trackage. The interchange of boxcars and the contracts executed pursuant thereto which provide for the incentive and basic rental charges increase the value of the local railroad franchise by enabling the railroad to participate in and receive the benefits of the "single common pool" of railroad boxcars. Moreover, the

[2] *Wallace* was cited in the *Norfolk & Western* case on which Maine Central relies. *Wallace* involved a tax on a foreign corporation, whereas the instant tax is on a domestic corporation. In *Wallace,* the special excise tax was invalidated because most of the major terminals (and thus most of the railroad's value) were located in other states even though a large amount of the railroad's trackage was in the taxing state. Here, in addition to the value of the benefits and protections accorded by Maine as the state of incorporation, no evidence in the record suggests other than that the major part of value of the entire railroad franchise is located in the State of Maine.

basic rental charges, in fact, immediately become part of the railroad's general corporate assets and the incentive income becomes part of general corporate assets when transformed by expenditure on additional boxcars. Thus, in light of the mandatory interchange of boxcars and the *significant financial benefits to the railroad even after it pays the costs of the excise tax,* we conclude, as before, that the taxpayer has not sustained its burden of proving that an excessive burden on interstate commerce resulted in 1974 from application of the Maine excise tax.

In *Maine* v. *Grand Trunk Railway Co.,* 142 U.S. 217 (1891), the United States Supreme Court upheld a prior version of the present Maine excise tax. In *Western Live Stock* v. *Bureau,* 303 U.S. 250, 256 (1938), *Grand Trunk* was cited with apparent approval as upholding a fairly apportioned tax on the value of the local privilege or franchise as measured by gross receipts from interstate commerce. We believe that *Grand Trunk* remains viable authority justifying us in upholding the same mileage apportionment formula in its application to the circumstances presently before us. As we observed in our original opinion, the 1927 addition of net railway operating income as a factor in rate computation results in an even more accurate reflection of the value of the railroad franchise.

The entry is:

(A) The stay of proceedings in the Superior Court ordered by this Court on December 7, 1977 pending this Court's consideration of the motion for reconsideration is lifted;

(B) This Court's prior entry of adjudication is reaffirmed and supplemented to read as follows:

(1) It is adjudicated: (a) correctly interpreted 36 M.R.S.A. § 2624 requires, for purposes of the computation of the Maine excise tax on

railroads, that incentive per diem charges be included in net railway operating income; (b) thus interpreted, 36 M.R.S.A. § 2624, taken facially as well as in its application to the circumstances of the present case, violates neither the Supremacy Clause of Article VI nor the Commerce Clause (Section 8 of Article I) of the Constitution of the United States;

(C) The case is remanded to the Superior Court with directions that said Court order (a) as to plaintiff's complaint, that judgment be entered in favor of the defendants; and (b) as to the counterclaim of defendant State Tax Assessor, that judgment be entered for defendant State Tax Assessor in the amounts sought by the counterclaim.

Pomeroy, J., did not participate.

Delahanty, J., did not participate in the consideration of the motion for reconsideration.

Dufresne, A.R.J., who sat at oral argument as Chief Justice and joined in the original opinion as Active Retired Justice, has joined in this opinion as Active Retired Justice.

Archibald, Godfrey, J. J., and Dufresne, A.R.J. concurring.

Attorneys for the Plaintiff:
Pierce, Atwood, Scribner,
Allen, Smith & Lancaster
By: William C. Smith, Esq.
James G. Good, Esq.
One Monument Square
Portland, Maine 04111

Attorneys for the Defendants:
Clifford B. Olson, Esq.
Jerome S. Matus, Esq.
Assistant Attorney Generals
State House
Augusta, Maine 04333

Henri Francis Rush, Esq.
Alan W. Heifetz, Esq.
Interstate Commerce Commission
Office of the General Counsel
Washington, D. C. 20423

Order of the Superior Court Entering Judgment

STATE OF MAINE	SUPERIOR COURT
KENNEBEC, SS	Civil Action
	Docket No. 75-927

MAINE CENTRAL RAILROAD COMPANY, *Plaintiff*

v.

RAYMOND L. HALPERIN, ET AL., *Defendants*

(RECEIVED AND FILED DECEMBER 30, 1977)

This action having been reported to the Law Court by order of this court dated December 22, 1976 and the Law Court having remanded the case by order dated November 16, 1977 to this court with directions for entry of judgment, having stayed further proceedings of this court by order dated December 7, 1977, and, upon reconsideration of its adjudication, having lifted said stay by order dated December 27, 1977,

And, the amount sought by the counterclaim of the State Tax Assessor being correctly computed as follows:

Assessment		$686,382.99
Less: Payment prior to filing of complaint (6/15/75)		23,541.40
Principal sought in counterclaim		$662,841.59
Less: Payments during pendency of action (9/15 and 12/15/75)		47,082.76
Principal currently due		$615,758.83
Interest @ 10% per year:		
On $205,252.93 for 2 years and 198 days (6/15/75 to 12/30/77)	$52,184.85	
On $205,252.93 for 2 years and 106 days (9/15/75 to 12/30/77)	47,011.35	
On $205,252.97 for 2 years and 15 days (12/15/75 to 12/30/77)	41,894.09	141,090.29
		$756,849.12

It is ORDERED (a) as to plaintiff's complaint, that judgment be entered in favor of defendants, and (b) as to the counterclaim of defendant State Tax Assessor, that judgment be entered for defendant State Tax Assessor in the amount of $756,849.12.

/s/ LEWIS I. NAIMAN
Justice, Superior Court

Dated: December 30, 1977

Notice of Appeal to the Supreme Court of the United States

[Filed: January 13, 1978]

STATE OF MAINE
KENNEBEC, ss

SUPERIOR COURT
Civil Action
Docket No. 75-927

Law Court
Docket No. KEN-77-14

MAINE CENTRAL RAILROAD COMPANY, *Plaintiff*

v.

RAYMOND L. HALPERIN, ET AL., *Defendants*

PLEASE TAKE NOTICE that Maine Central Railroad Company hereby appeals to the Supreme Court of the United States the final judgment entered by the Supreme Judicial Court of Maine in this action on December 27, 1977. The appeal is taken pursuant to 28 U.S.C. § 1257(2).

Respectfully submitted,

/s/ WILLIAM C. SMITH,
William C. Smith, Esq.
James G. Good, Esq.
Pierce, Atwood, Scribner
Allen, Smith & Lancaster
One Monument Square
Portland, Maine 04111

/s/ EUGENE D. GULLAND
Eugene D. Gulland, Esq.
Marc B. Tucker, Esq.
888 Sixteenth Street, N.W.
Washington, D.C. 20006

(CERTIFICATE OF SERVICE OMITTED IN PRINTING)

Maine Railroad Excise Tax

CHAPTER 361

RAILROAD COMPANIES

§ 2621. Annual returns

Every railroad company incorporated under the laws of the State or doing business therein shall annually, between the first and 15th days of April, return to the State Tax Assessor, signed by its treasurer or its chief accounting officer, a statement of the gross transportation receipts, the net railway operating income, the average number of miles operated in the system and the average number of miles operated in the State for the preceding calendar year.

§ 2622. Penalties

Any corporation, company or person willfully neglecting to make returns as provided in section 2621 forfeits $5 for every day's neglect, to be recovered by a civil action in the name of the State. Any officer, agent or employee of such railroad company who willfully violates any provision of section 2621 shall be punished by a fine of not less than $100 nor more than $500 for each offense, to be recovered by indictment to the use of the State.

§ 2623. Excise tax; payment to cities and towns one percent on stock held therein

Every corporation, person or association operating any railroad in the State under lease or otherwise shall pay to the State Tax Assessor, for the use of the State, an annual excise tax for the privilege of exercising its franchises and the franchises of its leased roads in the State, which, with the tax provided for in section 561, is in place of all taxes upon the property of such railroad.

§ 2624. Amount of tax

The amount of the annual excise tax on railroads shall be ascertained as follows: The amount of the gross transportation receipts as returned to the Public Utilities Commission for the year ended on the 31st day of December preceding the levying of such tax shall be compared with the net railway operating income for that year as returned to the Public Utilities Commission. When the net railway operating income does not exceed 10% of the gross transportation receipts, the tax shall be an amount equal to 3¼% of such gross transportation receipts. When the net railway operating income exceeds 10% of the gross transportation receipts but does not exceed 15%, the tax shall be an amount equal to 3¾% of the gross transportation receipts. When the net railway operating income exceeds 15% of the gross transportation receipts but does not exceed 20%, the tax shall be an amount equal to 4¼% of such gross transportation receipts. When the net railway operating income exceeds 20% of the gross transportation receipts but does not exceed 25%, the tax shall be an amount equal to 4¾% of such gross transportation receipts. When the net railway operating income exceeds 25% of the gross transportation receipts, the tax shall be an amount equal to 5¼% of such gross transportation receipts. When net railway operating income for the preceding year is less than 5¾% of investment in railway property used in transportation service, less depreciation and plus cash, including temporary cash investments and special deposits, and material and supplies, as reported by the railroad in its annual report to the Public Utilities Commission, the tax payable shall be diminished by a sum which added to said net railway operating income would equal 5¾% of the investment as aforesaid; except that in any event the tax payable shall not be diminished below a minimum amount equal to 1% of the gross transportation receipts for the year 1971 and equal to 9/10 of 1% of the gross transportation receipts for the year 1972 and

equal to ¼ of 1% of the gross transportation receipts for each succeeding year. In the case of railroads operating not over 50 miles of road, the tax shall not exceed 1¾% of the gross transportation receipts.

When a railroad lies partly within and partly without the State, or is operated as a part of a line or system extending beyond the State, the tax shall be equal to the same proportion of the gross transportation receipts in the State, and its amount shall be determined as follows: The gross transportation receipts of such railroad, line or system, as the case may be, over its whole extent, within and without the State, shall be divided by the total number of miles operated to obtain the average gross transportation receipts per mile, and the gross transportation receipts in the State shall be taken to be the average gross transportation receipts per mile multiplied by the number of miles operated within the State, and the net railway operating income within the State shall be similarly determined.

The term "net railway operating income" means the railway operating revenues less the railway operating expenses, tax accruals and uncollectible railway revenues, including in the computation thereof debits and credits arising from equipment rents and joint facility rents. The Public Utilities Commission, after notice and hearing, may determine the accuracy of any returns required of any railroad, and if found inaccurate, may order proper corrections to be made therein.

§ 2625. Determination of tax; notice to companies

The State Tax Assessor, on the first day of each May, shall determine the amount of the tax on railroad companies and shall forthwith give notice thereof to the corporation, person or association upon which the tax is levied.

§ 2626. Due date; payment to State Tax Assessor

The tax on railroad companies shall be payable 1/3 on the 15th day of June next after the levy is made, 1/3 on the 15th day of September and 1/3 on the 15th day of December next following. Such tax shall be payable to the State Tax Assessor, who shall pay over all receipts from such tax to the Treasurer of State daily.

§ 2627. Abatement

Any corporation, person or association aggrieved by the action of the State Tax Assessor in determining the tax on railroad companies, through error or mistake in calculating the same, may apply for abatement of any such excessive tax within the year for which such tax is assessed, and if, upon rehearing and reexamination, the tax appears to be excessive through such error or mistake, the said State Tax Assessor may thereupon abate such excess. The amount so abated shall be deducted from any tax due and unpaid upon the railroad upon which the excessive tax was assessed; or, if there is no such unpaid tax, the State Controller shall draw a warrant for the abatement, to be paid from any money in the treasury not otherwise appropriated.

§ 2628. Further returns; access to books by Public Utilities Commission

If the returns required by law in relation to railroads are found insufficient to furnish the basis upon which the tax on railroads is to be levied, the Public Utilities Commission shall require such additional facts in the returns as may be found necessary. Until such returns are so required, or, in default of such returns when required, the State Tax Assessor shall act upon the best information that he may obtain. The Public Utilities Commission shall have access to the books of railroad companies to ascertain if the required returns are correctly made. Any railroad corporation, association or person operating any railroad in the State, which refuses or neglects to make returns required by law or to exhibit to the Public Utilities Commission its books for the purposes aforesaid, or makes returns which the president, clerk, treasurer or other person certifying to such returns knows to be false forfeits not less than $1,000 nor more than $10,000, to be recovered by indictment or by a civil action in any county into which the railroad operated extends.

Interstate Commerce Act, Section 1, (14) (a) as amended by Pub. L. 89-430 (*eff. Sept., 1966*) with material added by Pub. L. 89-430 italicized.*

§ 1, par. (14). Establishment by Commission of rules, etc., as to car service

(a) The Commission may, after hearing, on a complaint or upon its own initiative without complaint, establish reasonable rules, regulations, and practices with respect to car service by common carriers by railroad subject to this chapter, including the compensation to be paid and other terms of any contract, agreement, or arrangement for the use of any locomotive, car, or other vehicle not owned by the carrier using it (and whether or not owned by another carrier), and the penalties or other sanctions for nonobservance of such rules, regulations, or practices. *In fixing such compensation to be paid for the use of any type of freight car, the Commission shall give consideration to the national level of ownership of such type of freight car and to other factors affecting the adequacy of the national freight car supply, and shall, on the basis of such consideration, determine whether compensation should be computed solely on the basis of elements of ownership expense involved in owning and maintaining*

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* Section 1(14)(a) was further amended by the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. 94-210, in respects not relevant to this case.

such type of freight car, including a fair return on value, or whether such compensation should be increased by such incentive element or elements of compensation as in the Commission's judgment will provide just and reasonable compensation to freight car owners, contribute to sound car service practices (including efficient utilization and distribution of cars), and encourage the acquisition and maintenance of a car supply adequate to meet the needs of commerce and the national defense. The Commission shall not make any incentive element applicable to any type of freight car the supply of which the Commission finds to be adequate and may exempt from the compensation to be paid by any group of carriers such incentive element or elements if the Commission finds it to be in the national interest.

Incentive Per Diem Regulations*

PART 1036—INCENTIVE PER DIEM CHARGES ON BOXCARS

Sec.
1036.1 Application.
1036.2 Amount of incentive charge.
1036.3 Earmarking.
1036.4 Use of funds.
1036.5 Effective date.
1036.6 Rules and regulations suspended.

AUTHORITY: The provisions of this Part 1036 issued under secs. 1 and 12 of the Interstate Commerce Act, 24 Stat. 379, 383, as amended; 49 U.S.C. 1, 12.

SOURCE: The provisions of this Part 1036 appear at 35 F.R. 7122, May 6, 1970, unless otherwise noted.

* Regulations in effect as of December 31, 1976, as contained in the most recent edition of the Code of Federal Regulations. Because of certain technical amendments, the regulations in effect during 1974 and 1975 (*see* R. 174-76) differed in respects not material to this case.

§ 1036.1 Application.

Each common carrier by railroad subject to the Interstate Commerce Act shall pay to the owning railroads, including the owning railroads of Canada, the additional per diem charges set forth in § 1036.2 on all boxcars shown below,

Mechanical designation	*Code number*
XM	B100-109, B200-209, B300-309.
XMI	B110-119, B210-219, B310-319.
XMIH	B120-129, B220-229, B320-329.
VA	B040.
VM	B050.
XC	B060.
XCI	B070.
XU	B080.

while in the possession of nonowning railroads and subject to per diem rules. These charges are in addition to all other per diem charges currently in effect or prescribed Mexican-owned cars are exempt from the operation of these rules. The rules of this part shall apply regardless of whether the foregoing boxcars are in intrastate, interstate, or foreign commerce.

[35 F.R. 7122, May 6, 1970, as amended at 36 F.R. 13997, July 29, 1971]

§ 1036.2 Amount of incentive charge.

The incentive charges applicable in each cost bracket by age group are set forth below:

AMOUNT OF INCENTIVE PER DIEM ON BOXCARS
(COLLECTIBLE IN 6 MONTHS IN EACH YEAR)

Line No.	Cost bracket (1)	Group A 0-5 years (2)	Group B 6-10 years (3)	Group C 11-15 years (4)	Group D 16-20 years (5)	Group E 21-25 years (6)	Group F 26-30 years (7)	Group G over 30 years (8)
1	0-$1,000	$0.32	$0.27	$0.22	$0.17	$0.11	$0.06	$0.04
2	$1,000-$3,000	.65	.54	.44	.33	.23	.12	.07
3	$3,000-$5,000	1.30	1.09	.88	.67	.46	.25	.14
4	$5,000-$7,000	1.95	1.63	1.32	1.00	.68	.37	.21
5	$7,000-$9,000	2.60	2.18	1.75	1.33	.91	.49	.28
6	$9,000-$11,000 ...	3.25	2.72	2.19	1.67	1.14	.61	.35
7	$11,000-$13,000 ..	3.90	3.26	2.63	2.00	1.37	.74	.42
8	$13,000-$15,000 ..	4.54	3.81	3.07	2.33	1.60	.86	.49
9	$15,000-$17,000 ..	5.19	4.35	3.51	2.67	1.82	.98	.56
10	$17,000-$19,000 ..	5.84	4.89	3.95	3.00	2.05	1.11	.63
11	$19,000-$21,000 ..	6.49	5.44	4.39	3.33	2.28	1.23	.70
12	$21,000-$23,000 ..	7.14	5.98	4.82	3.67	2.51	1.35	.77
13	$23,000-$25,000 ..	7.79	6.53	5.26	4.00	2.74	1.47	.84
14	$25,000-$27,000 ..	8.44	7.07	5.70	4.33	2.96	1.60	.91
15	$27,000-$29,000 ..	9.09	7.61	6.14	4.67	3.19	1.72	.98
16	$29,000-$31,000 ..	9.74	8.16	6.58	5.00	3.42	1.84	1.05
17	$31,000-$33,000 ..	10.39	8.70	7.02	5.33	3.65	1.96	1.19
18	$33,000-$35,000 ..	11.04	9.24	7.46	5.67	3.88	2.09	1.12
19	$35,000-$37,000 ..	11.69	9.79	7.89	6.00	4.10	2.21	1.26
20	$37,000-$39,000 ..	12.33	10.33	8.33	6.33	4.33	2.33	1.33
21	$39,000-$41,000 ..	12.98	10.88	8.77	6.67	4.56	2.46	1.40

§ 1036.3 Earmarking.

Each common carrier by railroad shall segregate in Account 716, Capital and Other Reserve Funds, and shall transfer from Account 798, Retain Income, Unappropriated to Account 797, Retained Income, Appropriated, an amount

equal to the net credit balance resulting from any incentive per diem settlement involving boxcars subject to this part. The carriers shall maintain a separate bank account for the segregated funds. Canadian carriers shall transfer a net balance after taxes to a U.S. designee, which may be either a United States class I railroad or a United States corporation established solely to purchase, hold title to, and control general service, unequipped boxcars subject to the Department of Transportation's safety regulations and the Interstate Commerce Commission's rules pertaining to per diem and car service, and to any reporting requirements determined to be applicable by the Commission's Bureau of Accounts. If the designee of Canadian carriers is a United States railroad, it shall maintain a separate account for funds received on Canadian-owned boxcars. All boxcars purchased or built by such designee or such other corporation with incentive per diem funds earned on Canadian boxcars must be built in the United States. Any United States taxes incurred after transfer of a net balance to such designee may be deducted from the transferred amount for the purpose of determining a final net balance for investment. The earmarked funds shall be reduced by the amount of the additional income tax paid as the result of increasing taxable income by inclusion of net incentive per diem earnings. The funds in such account shall be used to purchase, lease, or build new, unequipped boxcars for general service or to rebuild general service, unequipped boxcars with code numbers and mechanical designations set forth in § 1036.1 for addition to such carrier's or designee's fleet in accordance with this part. The unexpended funds remaining in the accounts of the carriers may be invested in Government bonds or other interest-bearing, temporary securities. The interest earned thereafter shall become part of the earmarked fund.

[40 FR 16846, Apr. 15, 1975]

§ 1036.4 Use of funds.

The net credit balances resulting from incentive per diem settlements, which are earmarked in accordance with § 1036.3, may be drawn down in whole or in part at any time by the carrier to build, lease equivalent of purchase, or purchase, in whole or in part, new unequipped boxcars for general service described in § 1036.1, *provided,* The carrier has in the same calendar year built, leased, or purchased its 1964-68 average acquisitions of such boxcars and made up an arrearage in having failed to maintain such average each year this order is in effect. Earmarked funds may also be used in whole or in part to lease any number of new unequipped boxcars for general service described in § 1036.1, in which the carrier is not acquiring an equity interest, *provided,* The carrier has in the same calendar year leased its 1964-68 average number of such boxcars and made up any arrearage in having failed to maintain such average each year the order is in effect. Nonequity leases must be at least 10 years in duration and in connection with such leases, earmarked funds must not be used for the cost of maintenance. Earmarked funds may be used in whole or in part to rebuild any number or portion of general service, unequipped boxcars described in § 1036.1, *provided,* The carrier has in the same calendar year rebuilt its 1964-68 average number of such boxcars and made up any arrearage in having failed to maintain such average each year the order is in effect. Net balances on Canadian-owned cars may be drawn down without regard to prior acquisitions, but where the designee is a class I United States carrier such drawdowns shall not affect that carrier's accumulation of arrearages resulting from prior failure to build, rebuild, lease, or purchase its 1964-68 arrearages. However, upon application, including a showing that all parties to the proceeding herein have been notified by the carrier on such application and a showing of good cause why any carrier is unable to draw down in whole or in part the net credit balance resulting from incentive per

diem settlements because it cannot comply with the above test period average requirements of having in the same calendar year built, rebuilt, leased, or purchased its 1964-68 average number of such boxcars and made up any arrearage in having failed to maintain such average each year this order is in effect, the Commission may, in its discretion, after consideration of all views regarding the application, modify the test period average to the extent consistent with the public interest and the national transportation policy. Such modification, as a minimum, shall require that a carrier match the earmarked funds it will use with an equal amount of its own funds. Earmarked funds must be put to use within 18 months after the end of the calendar year in which the funds are collected and result in a net credit balance for the building, rebuilding, leasing, or purchasing of general service, unequipped boxcars described in § 1036.1 for addition to such carrier's or designee's fleet in accordance with this part. Upon a showing of good cause an application, including a showing that the parties to the proceeding herein have been notified by the carrier of such application may be made to the Commission for waiver of the said 18-month period, which may, in the Commission's discretion, be granted after consideration of all views regarding the application. If the earmarked funds are not used within the 18-month period, they may be voluntarily surrendered to Rail Box whose establishment and operation was approved in Finance Docket No. 27589, *American Rail Box Car Company and Trailer Train Company, et al.—For Approval of the Pooling of Car Service with Respect to Box Cars.* If the carrier fails within the stated period to put to use collected earmarked funds which result in a net credit balance, has not obtained relief from that requirement, and has not surrendered such funds to Rail Box, the Commission will investigate the matter to determine what, if any, corrective action is warranted. Appropriate corrective action would include section 16(12) remedies among others. Carriers may make temporary investments of unexpended

funds in Government bonds or other liquid securities. Such securities must be readily convertible to cash so that funds remain available for boxcar purchases. Interest earned must become part of the earmarked fund. As used in this section, "build," "rebuild," "lease," or "purchase" refer to a commitment to build, rebuild, lease, or purchase which results in the acquisition of a car on line ready for use within 10 months from the date of commitment, except that in extraordinary cases beyond the control of the carrier or the car supplier, a car that is delivered after 10 months from the date of commitment may qualify if approved by the Bureau of Accounts of this Commission.

[40 FR 16846, Apr. 15, 1975]

§ 1036.5 Effective date.

The rules set forth in §§ 1036.1 and 1036.2 shall be effective from May 1, 1973, and shall continue in effect until further order of the Commission" and substituting therefor the words "apply for a 6-month period from September 1 of each year through February 28 of the following year on unequipped general service boxcars. The rules set forth in § 1036.1 and 1036.2 shall apply on XF cars on a year-round basis."

[35 FR 7122, May 6, 1970, as amended at 38 FR 8657, Apr. 5, 1973; 40 FR 33220, Aug. 7, 1975]

§ 1036.6 Rules and regulations suspended.

The operation of all rules and regulations, insofar as they conflict with the provisions of this part, is hereby suspended. The charges herein provided shall be paid for each day cars are held, but nothing in this part shall prevent the operation of per diem reclaim agreements customarily employed by and between particular railroads to provide for special situations, or with the use of customary methods of settling balances of per diem accounts.

No. 77-1373

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

MAINE CENTRAL RAILROAD COMPANY, *Appellant*

v.

RAYMOND L. HALPERIN, et al., *Appellees*

On Appeal from the Supreme Judicial Court of Maine

MOTION TO DISMISS OR AFFIRM

CLIFFORD B. OLSON
Assistant Attorney General
State of Maine
Department of the Attorney General
State House
Augusta, Maine 04333
(207) 289-2076

Attorney for Raymond L. Halperin, Joseph E. Brennan and the State of Maine

April 26, 1978

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TABLE OF AUTHORITIES

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1373

MAINE CENTRAL RAILROAD COMPANY, *Appellant*

v.

RAYMOND L. HALPERIN, et al., *Appellees*

On Appeal from the Supreme Judicial Court of Maine

MOTION TO DISMISS OR AFFIRM

Appellees move the Court to dismiss this appeal or affirm the judgment of the Supreme Judicial Court of Maine on the ground that the appeal does not present a substantial federal question.

QUESTIONS PRESENTED

1. Whether inclusion of incentive per diem charges in the computation of the Maine railroad excise tax frustrates the federal incentive per diem program and, therefore, violates the supremacy clause of the Constitution.

2. Whether the Maine railroad excise tax fails to reasonably apportion appellant's interstate business activities and, therefore, violates the commerce clause or the due process clause of the Constitution.

STATEMENT

Maine Central Railroad Company (Maine Central) is a Maine corporation which, in 1974, operated 765 miles of railroad in Maine and a total of 143 miles in New Hampshire, Vermont, and New Brunswick. Because of its operations in Maine, the railroad was subject to the Maine railroad excise tax, 36 M.R.S.A. §§ 2623 *et seq.*, a franchise tax levied in lieu of property tax on the land and fixtures within the railroad's located right-of-way (R. 39).

The tax base of the Maine railroad excise tax is the railroad's "gross transportation receipts" (GTR).[1] The tax rate is governed by the ratio of the railroad's "net railway operating income" (NROI) to its gross transportation receipts; as the ratio increases, the rate increases, in ½ percent increments, from 3¼ percent to 5¼ percent. The tax determined by application of the appropriate rate to the railroad's gross transportation receipts is then "diminished" by the amount by which 5¾ percent of the sum of railway property used in transportation service (less depreciation), cash (including temporary cash investments and special deposits), and material and supplies exceeds the railroad's net railway operating income. This diminution factor is the critical element in determining a railroad's excise tax liability since, in many cases, the amount of tax initially determined would be reduced to zero. Under that circumstance, the minimum tax of ¼ of 1 percent of gross transportation receipts takes effect. 36 M.R.S.A. § 2624. The diminished tax

[1] The tax base is not the totality of a railroad's gross receipts as appellant erroneously states (Jur. St. 4-5, 6-7). The appendix to this motion outlines the relationship of railway accounting terms.

or minimum tax, whichever is applicable, is then apportioned by the ratio of the railroad's Maine miles to total system miles to determine the final tax.[2]

This case originated in Maine Central's attempt to exclude certain revenue from the computation of its Maine railroad excise tax for 1974 since reporting of its income in the usual manner would substantially increase the railroad's tax liability for that year. Because of its high level of 1974 earnings, the railroad became subject to nearly the full effect of a 3¾ percent tax rate rather than to the minimum rate to which it had grown accustomed. To justify a reduction in liability, the railroad claimed that the Maine railroad excise tax statute did not contemplate the inclusion of so-called "incentive per diem" (IPD) freight car rental income in the tax computation formula because the use of that income was restricted by the Interstate Commerce Commission (ICC).

The "numerous restrictions" cited by Maine Central (Jur. St. 9, 14) are essentially two — the "earmarking" and "quota" provisions. "Earmarking" requires that IPD funds be used only for boxcar acquisitions and payment of income tax attributable to IPD income. 49 C.F.R. § 1036.3 (1976). Under the "quota" restriction, a railroad, prior to using IPD funds, must have acquired, for each year the IPD program has been in effect, the average number of boxcars which it acquired in the 1964-68 "test period". 49 C.F.R. § 1036.4 (1976).

Upon the State Tax Assessor's refusal to accept Maine Central's proposed exclusion of IPD revenues from the tax formula, the railroad brought an action

[2] A chart illustrating the operation of the Maine railroad excise tax appears at R. 186.

for declaratory judgment in the Superior Court of Kennebec County, Maine. In addition to its statutory construction argument, Maine Central alleged that inclusion of IPD revenues in the tax computation would unconstitutionally frustrate the federal boxcar acquisition program and burden interstate commerce. The action was reported on an agreed statement of facts to the Supreme Judicial Court of Maine.

The Supreme Judicial Court found that, although the IPD credit balance is earmarked for boxcar acquisitions and therefore bears some of the characteristics of a trust fund, it confers a direct and substantial benefit upon the IPD creditor railroads, who, upon expenditure of the restricted funds, become the outright owners of the acquired boxcars. *Maine Central R.R. v. Halperin,* 379 A.2d 980, 984 (Me., 1977) (Jur. St. 8a). Consequently, IPD revenues were properly included in the computation formula used to value Maine Central's franchise.

The court below further concluded, notwithstanding the obvious fact that an increased tax liability would reduce the taxpayer's general corporate funds, that Maine Central had shown neither inability nor disincentive to participate in the IPD program. 379 A.2d at 986-987. (Jur. St. 11a-14a). Moreover, even Maine Central's unlikely withdrawal from boxcar acquisitions would not frustrate the federal program because the ICC has specifically provided for use of the restricted funds under those circumstances. 379 A.2d at 987-988 (Jur. St. 14a-16a). Thus, an implied prohibition of state taxation was unwarranted.

Finally, the court below rejected the concept that a state, in levying a franchise tax, must apportion each individual item which comprises the value of the fran-

chise. The court did not minimize the importance of fair apportionment, as Maine Central charges (Jur. St. 13), but, rather, determined that the bulk of Maine Central's franchise value is located in Maine and therefore is appropriately apportioned to Maine. *Maine Central R.R. v. Halperin,* 381 A.2d 8, 11 (Me., 1977) (Jur. St. 28a-29a). Accordingly, the Supreme Judicial Court denied the relief sought by Maine Central and granted the defendants' counterclaim for the contested amount of tax plus statutory interest.

ARGUMENT

1. Inclusion of incentive per diem income in the computation of the Maine railroad excise tax does not frustrate the federal incentive per diem program and, therefore, does not violate the supremacy clause of the Constitution.

The Supreme Judicial Court of Maine adhered completely to the precedents of this Court in determining, on the facts, that imposition of the Maine railroad excise tax did not frustrate the full effectiveness of the federal incentive per diem program.

Maine Central attempts to discredit the decision below by attributing to the ICC an express intent that the IPD program should not create any burden, however indirect, upon a railroad's general corporate funds (Jur. St. 14, 19). However, no such intent appears in the record in any official form; appellant relies for this point only upon the speculation of an employee of the ICC (R. 202). The ICC did expressly provide relief by allowing railroads to use restricted IPD funds to pay incremental federal and state income taxes attributable to the earning of IPD revenues (R. 124). However, as the court below concluded, the fact that the ICC has granted this relief and none other suggests that the commission considers neither direct income

taxation of the restricted IPD fund nor the imposition of other IPD-related liabilities upon general corporate funds to frustrate the federal program. 379 A.2d at 988n.12 (Jur. St. 17a n.12). Where the intent of Congress and federal regulatory agencies is so uncertain, this Court has avoided taking irrevocable action against the state. *Penn Dairies v. Milk Control Commission of Pennsylvania*, 318 U.S. 261, 275 (1943). We submit that such a course is proper in this case.

The decision below was essentially a factual determination that inclusion of the IPD credit balance in the computation of the Maine railroad excise tax does not interfere with the federal IPD program. This result finds overwhelming support in the record, as follows:

1. The inclusion of IPD credits in the computation of the Maine railroad excise tax for 1974 does not impair the ability of Maine Central to participate in the IPD program. The State of Maine recognized, of course, that payment of the excise tax from the restricted IPD fund would directly conflict with the IPD program. Accordingly, the state proposed that the tax be paid from the railroad's general corporate funds.

Maine Central's general corporate funds were sufficient, at least in 1975 when the excise tax was due, to pay the entire tax, contrary to the suggestions (Jur. St. 20-21; R. 200; R. 207) of appellant and its witnesses. As stipulated, Maine Central's unrestricted ordinary income for 1974 was $1,004,105, substantially in excess of the $615,000 incremental tax resulting from inclusion of IPD revenues in the tax computation formula (R. 37-38). Moreover, on December 31, 1974, Maine Central had working capital of over $5 million, including temporary cash investments of $5,365,000

(R. 39). Thus, payment of the full tax would in no way have impaired Maine Central's capital assets, as alleged in the railroad's complaint (R. 15).

Maine Central has failed to show that the excise tax assessed by the State of Maine would prevent its compliance with the quota requirement, 49 C.F.R. § 1036.4 (1976), which is a prerequisite to the expenditure of restricted IPD funds. Maine Central's quota was never introduced into evidence; the quota could conceivably be zero or so low that it would constitute no impediment. Moreover, a freight car study conducted by the ICC indicated that nine of the fifteen leading per diem creditor railroads either exclusively purchased new boxcars or exclusively rebuilt old boxcars during the 1964-68 test period. *Incentive Per Diem Charges — 1968*, 337 I.C.C. 183, 192, 212 (1969) (R. 55, 75). This suggests that, for many railroads, the quota requirement is meaningless. A railroad in this position could have free access to restricted IPD funds by using the opposite acquisition method from that which it employed in 1964-68 (e.g. by rebuilding boxcars if it had exclusively purchased boxcars in 1964-68). Thus, the court below validly rejected Maine Central's quota arguments. 379 A.2d at 987 (Jur. St. 14a).

2. The inclusion of IPD credits in the Maine railroad excise tax computation for 1974 has not demonstrably reduced Maine Central's incentive to participate in the IPD program. To the contrary, the record strongly suggests that Maine Central is heavily engaged in the IPD program notwithstanding its pending excise tax liability. The railroad leased 250 boxcars in August, 1974 (p. 20 of *Maine Central Railroad Company Annual Report - 1975*, transmitted *in specie* as Exhibit Q to Agreed Statement of Facts). In addi-

tion, Maine Central rebuilt 100 boxcars in 1974-75 (62 in 1975) through the use of IPD funds (*Id.*, p. 10). Finally, the railroad made a commitment in November, 1975 for the acquisition of 500 new boxcars — in itself a 15.9 percent increase in Maine Central's boxcar fleet (*Id.*).

3. Maine Central's 1974 excise tax liability was an anomaly, caused by the railroad's highest earnings in its 112-year history (p. 3 of Maine Central *1974 Annual Report*, transmitted *in specie* as Exhibit P to Agreed Statement of Facts). In most situations, inclusion of the IPD credit balance in the tax computation does not affect the amount of Maine railroad excise tax liability. In this regard, the Supreme Judicial Court of Maine concluded that:

> because incentive per diem charges as such are not taxed by the excise tax but, rather, are merely included in the computation by which the applicable rate becomes determined, an increase of incentive funds need not necessarily produce a greater excise tax liability. 379 A.2d at 986 (Jur. St. 12a).

The conclusion is supported not only by examination of the mechanics of the tax (R. 186) but also by stipulated facts. Maine Central's excise tax liability for the years 1970-1973 was not changed by the inclusion of IPD credits in the computations (R. 40-41). For 1975, Maine Central's excise tax liability as assessed was $67,174 (R. 39), which is shown by simple arithmetic to result from application of the minimum tax rate of 1/4 of 1 percent to the railroad's gross transportation receipts of $31,892,172 (R. 189, lines 1-4) and apportionment of the result by the 84.25 percent mileage factor. In addition, since the beginning of the IPD program, no other railroad operating in Maine has experienced an increase in excise tax liability because of the

inclusion of IPD credits in the tax computation (R. 41).

4. Finally, while Maine Central has not established either a present or future disability or disincentive to participate in the IPD program, the court below nevertheless took into account the possibility of such an event. The Supreme Judicial Court correctly noted that the ICC itself had actively planned for such a contingency by providing alternatives[3] to ensure that all IPD funds will be spent on boxcar acquisitions. 379 A.2d at 987-988 (Jur. St. 14a-15a). Thus, the federal IPD program cannot be frustrated by an individual railroad's action.

The recommendation of the court below that Maine Central use its financial planning resources to develop strategies for optimal participation in the IPD program, 379 A.2d at 988 (Jur. St. 16a), is the necessary product of the railroad's having presented only vague predictions of financial disaster, unsubstantiated by concrete financial analysis. The railroad did not meet its burden of proving frustration of the federal program because such suggestions are a direct contradiction of Maine Central's documented participation in boxcar acquisitions. When the court below has clearly followed the precedents of this Court and the evidence so strongly supports the result, we submit that the question presented is too insubstantial to warrant further argument.

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[3] A railroad may surrender unused IPD funds to Rail Box Corporation. 49 C.F.R. § 1036.4 (1976). If a railroad does not use the funds, obtain relief from the ICC, or surrender the funds to Rail Box within 18 months after the end of the year in which they were collected, the ICC will investigate and take appropriate corrective action. *Id.*

2. **The Maine railroad excise tax reasonably apportions appellant's interstate business activity and, therefore, does not violate either the commerce clause or the due process clause of the Constitution.**

The present Maine railroad excise tax cannot be distinguished from that upheld by this Court in *Maine v. Grand Trunk Ry.*, 142 U.S. 217 (1891). *Grand Trunk* held that the value of the privilege of exercising the railroad's franchises in Maine was validly measured by reference to the railroad's gross transportation receipts. 142 U.S. at 228-229. As explained in *Galveston, H. & S.A. Ry. v. Texas*, 210 U.S. 217 (1908), the *Grand Trunk* taxing system contemplated the exemption of the railroad's right-of-way from property taxation and replacement of that tax with an excise tax on the property value of the franchise in those states in which the railroad operated a right-of way. 210 U.S. at 226. The apportionment formula, in turn, was based upon the assumption that the franchise value was equally distributed along the railroad's right-of-way. *Id.* Although the tax rate is now determined by the ratio of net railway operating income to gross transportation receipts rather than by the average GTR per mile and the tax initially computed is now subject to diminution, the basic concept of the tax remains the same. 379 A.2d at 990 (Jur. St. 20a-21a).

Maine Central's emphasis on the apportionment of net railway operating income (Jur. St. 24, 27) is misplaced. The apportionment of NROI, in itself, is inconsequential to the fairness of the apportionment of the entire Maine railroad excise tax. NROI controls the amount of the tax (by affecting the tax rate and the amount of diminution) and not the apportionment of the tax. The property value of the franchise, rather than NROI, is the subject of apportionment. In the

Maine railroad excise tax upheld in *Grand Trunk, supra*, apportionment of the tax was achieved by apportioning gross transportation receipts on the basis of mileage and multiplying Maine GTR by the tax rate. 142 U.S. at 218n.1. The same result would have been attained by multiplying total GTR by the tax rate and apportioning the product by the mileage factor. The similarity of the existing apportionment provision to the *Grand Trunk* provision suggests that the Maine Legislature, to avoid having to rewrite the entire statute upon adoption of the gross-net method of taxation, apportioned NROI to allow it to be compared with GTR on equal terms. *See* 36 M.R.S.A. § 2624. Since the mileage factor is applied to both NROI and GTR, the effect is no different than if NROI and GTR were compared at full value to determine the tax rate and NROI and $5\frac{3}{4}$ percent of railroad investment were compared at full value to determine the diminution amount. By the latter method, the full franchise value is determined and then apportioned on the basis of mileage to arrive at the same tax as that which results from separate apportionment of each element of the tax. Thus, the apportionment issue in this case is not whether NROI is properly apportioned but whether the mileage factor reasonably distributes the value of the privilege taxed.

Maine Central's reliance on *Norfolk & Western Ry. v. Missouri State Tax Commission*, 390 U.S. 317 (1968), is also inappropriate. In *Norfolk*, this Court overturned an ad valorem property tax because the mileage apportionment formula produced a grossly distorted representation of the actual location of the railroad's rolling stock. As the Supreme Judicial Court of Maine concluded, 381 A.2d at 10 (Jur. St. 26a-27a), the tangible property involved in *Norfolk* (including its augmented going-concern value) could be specific-

ally identified and shown not to be equally distributed along Norfolk & Western's line. On the other hand, the value of Maine Central's franchise was augmented by freight car movements throughout the continent, but no evidence was presented to show that the franchise value itself was distributed other than equally along the railroad's right-of-way. 381 A.2d at 11n.2 (Jur. St. 28a n.2).

Even if part of Maine Central's franchise value were located outside those jurisdictions in which it operated a right-of-way, the railroad did not establish that that part of the franchise value must be apportioned to jurisdictions other than those in which it operated a right-of-way. Maine Central's right-of-way lies only in Maine, New Hampshire, Vermont and New Brunswick. No showing has been made that Maine Central had any contact in 1974 with any other state or province except for the random movement of some of its cars through some of those states and provinces on the tracks of other railroads because of mandatory interchange. This Court's holding in *Central R.R. of Pennsylvania v. Pennsylvania*, 370 U.S. 607 (1962) strongly suggests that such tenuous contact does not confer nexus for taxation. In *Central*, the domiciliary state was allowed to levy an ad valorem property tax on the unapportioned value of a railroad's rolling stock where the railroad showed that part of its rolling stock was absent from the domiciliary state for part of the year but failed to show either that the rolling stock traveled fixed and regular routes through particular non-domiciliary states or that a substantial part of the rolling stock was habitually employed in particular non-domiciliary states. 370 U.S. at 615. To the extent that such activity does not produce a situs for property tax purposes, we believe it does not produce a nexus for franchise taxation.

Moreover, even under Maine Central's theory that the Maine railroad excise tax is a tax on gross receipts as such, the apportionment result would not have been that sought by the railroad. This Court has held that such taxes are to be apportioned to reflect the taxpayer's activity in the taxing state. *Gwin, White & Prince v. Henneford*, 305 U.S. 434, 439 (1939). Maine Central would like to create the impression that freight car rentals, which are the basis for IPD revenues, constitute the bulk of its business activity. However, the net railway operating income account is a false indicator of the railroad's business activity. Examination of the railroad's income account (p. 14 of Maine Central's *1974 Annual Report*, transmitted *in specie* as Exhibit P to Agreed Statement of Facts) shows that Maine Central had $36,199,711 in gross revenues ($34,135,-977 "total railway operating revenues" plus $2,063,734 "net rents") in 1974. The bulk of Maine Central's business activity involved the hauling of freight, which accounted for $33,435,409, or 92.4 percent, of the railroad's gross revenues (*Id.*). By contrast, freight car rentals ($2,714,947),[4] the entire subject of this commerce clause and due process clause appeal, constituted only 7.5 percent of Maine Central's gross revenues for 1974. The railroad has not even attempted to show that any of the remaining 92.5 percent of Maine Central's activity is malapportioned. Thus, even if freight car rental revenues were apportioned in accordance with Maine Central's arguments, only a small change in the overall apportionment formula would be warranted. Moreover, the apparent lack of nexus demon-

[4] "Hire of freight cars" is part of the "net rents" account. Maine Central's total net rents for 1974 were less than freight car rental credits because the railroad had a debit balance in its "joint facility rents" account.

strated above casts serious doubt on whether even the freight car rental income (7.5 percent of gross revenues) would have to be apportioned in accordance with the location of Maine Central's freight cars when those revenues were earned.

Since net railway operating income is a net profit figure, apportionment by the locus of the elements of NROI, as advocated by Maine Central (Jur. St. 24, 27), would constitute a weighting of business activity to reflect profitability. Maine Central has cited no authority for the proposition that the Constitution of the United States requires such a weighted apportionment. Even if this novel concept were adopted, the exact apportionment would not be that suggested by the railroad. Freight car rental credits merely appear to be responsible for 80 percent of Maine Central's 1974 NROI because, under ICC accounting regulations, all operating expenses and taxes (other than taxes related to extraordinary items) are applied against "total railway operating revenues". The result ("total railway operating income") is added to "net rents", a gross revenue account,[5] to determine NROI (p. 14 of *1974 Annual Report*). Under this accounting format, none of the expenses which are fairly attributable to net rents (e.g. freight car depreciation for the period of time during which the car is earning IPD credits) are applied against that income. Thus, downward adjustment of freight car rental income as a percentage of net railway operating income would be necessary to accurately apportion the profitability of Maine Central's activities.

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[5] "Net rents" is essentially a gross revenue account, since "net" refers only to the offset of rental credits against rental debits. 49 C.F.R. 1201 (account no. 503)

Maine Central has failed to show, both under the Supreme Judicial Court's characterization of the tax and under its own, that the mileage apportionment formula generally approved for taxation of transportion companies, *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653, 663 (1948), *Canton R.R. v. Rogan*, 340 U.S. 511, 515-516 (1951), yielded, for 1974, a grossly distorted result of the kind condemned in *Norfolk & Western Ry. v. Missouri State Tax Commission, supra*. The railroad does not raise a substantial constitutional question but, rather, a pro-forma objection to the significant increase in tax liability which resulted when the railroad's profits overran the statutory relief provisions which ordinarily reduce Maine Central's railroad excise tax to the minimum.

CONCLUSION

For the reasons set out above, the Court should dismiss this appeal or affirm the judgment of the Supreme Judicial Court of Maine.

Respectfully submitted,

CLIFFORD B. OLSON
Assistant Attorney General
State of Maine
Department of the Attorney General
State House
Augusta, Maine 04333
(207) 289-2076
Attorney for Raymond L. Halperin, Joseph E. Brennan and the State of Maine

April 26, 1978

APPENDIX

RELATIONSHIP OF RAILWAY ACCOUNTING TERMS[1]

	Maine Central 1974 operations
GROSS TRANSPORTATION RECEIPTS (GTR)	
Freight	$33,435,409
Passenger	1,450
Switching	90,363
Other Transportation	3,092
	$33,530,314
RAILWAY OPERATING REVENUES	
GROSS TRANSPORTATION RECEIPTS	$33,530,314
Incidental	583,563
Joint Facility	22,100
	$34,135,977
RAILWAY OPERATING EXPENSES	
Maintenance of Way and Structures	$ 7,378,763
Maintenance of Equipment	7,154,641
Traffic	519,352
Transportation	12,062,295
General	2,042,841
	$29,157,892

[1] Source: Maine Central *1974 Annual Report* (transmitted *in specie* as Exhibit P to Agreed Statement of Facts) p. 14, supplemented by plaintiff's 1974 Maine railroad excise tax return (R. 180)

NET RENTS		
Hire of Freight Cars		$ 2,714,947
Other Equipment Rents		3,395
Joint Facility Rents		(654,608)
		$ 2,063,734
NET RAILWAY OPERATING INCOME (NROI)		
RAILWAY OPERATING REVENUES		$34,135,977
NET RENTS		2,063,734
		$36,199,711
Less:		
RAILWAY OPERATING EXPENSES		$29,157,892
Taxes:		
	Railway Tax Accruals	3,575,726
	Prov. for Deferred Taxes	60,840
		$32,794,458
		$ 3,405,253

No. 77-1373

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

MAINE CENTRAL RAILROAD COMPANY, *Appellant*,

v.

RAYMOND L. HALPERIN, et al., *Appellees*.

On Appeal from the Supreme Judicial Court of Maine

REPLY TO MOTION TO DISMISS OR AFFIRM

PETER J. NICKLES
EUGENE D. GULLAND
MARC B. TUCKER
COVINGTON & BURLING
888 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 452-6000

WILLIAM C. SMITH
JAMES G. GOOD
PIERCE, ATWOOD, SCRIBNER, ALLEN, SMITH & LANCASTER
One Monument Square
Portland, Maine 04111
(207) 773-6411

Attorneys for Maine Central Railroad Company

Of Counsel:
SCOTT W. SCULLY
General Counsel
MAINE CENTRAL RAILROAD COMPANY
242 St. John Street
Portland, Maine 04102
(207) 773-4711

May 1978

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REPLY TO MOTION TO DISMISS OR AFFIRM

In their Motion to Dismiss or Affirm, appellees mischaracterize certain issues, fail to address others and misconceive constitutional principles governing the questions presented.

I. THE SUPREMACY CLAUSE ISSUE.

1. Appellees attempt to dismiss, as mere "speculation of an employee of the I.C.C." (Motion to Dismiss, p. 5), the stipulated and uncontradicted testimony of a Commission official in the court below. Buttressed by the Commission's regulations and interpretive rulings, he detailed the restrictions on the use of IPD funds; he explained the Commission's intent that IPD receipts should not increase the tax liability a carrier must pay out of its general corporate funds; and he

described the tendency of the Maine Railroad Excise Tax as it was interpreted and applied in this case to frustrate the full effectiveness of the IPD program by burdening appellant's general corporate assets, lowering its rate of return on boxcars below that which the Commission has found necessary to stimulate acquisition of boxcars, and threatening the ability of railroads in Maine to acquire with their own funds the quota of boxcars that must be satisfied before restricted IPD funds may be used. (Juris. St., pp. 15, 17-22.)

The Interstate Commerce Commission official who appeared below was authorized by the Commission to testify as an expert concerning the purposes, structure and policies of the IPD regulations. The Commission intervened as *amicus curiae* in support of appellant's position, and its counsel participated in the preparation of the Agreed Statement of Facts that included the testimony. Commission counsel signed the Agreed Statement. (*See* R. 43.) Furthermore, counsel for the Commission advises counsel for appellant that the Commission adheres to the position it took below and will confirm its position should the Court so desire. The entire premise of appellees' argument—the view that the Commission's intent is "so uncertain" (Motion to Dismiss, p. 6)—is a weak premise indeed.

2. When they contend that it is essentially a factual question whether application of Maine's excise tax to IPD receipts in this case frustrates the federal IPD program (Motion to Dismiss, p. 6), appellees ignore the direct conflict with the IPD regulations posed by the refusal of the court below to give effect to the earmarking restrictions contained in the regulations. Moreover, their factual analysis, like that of the court below, rests on the erroneous assumption that the state

tax officials and state courts may, without running afoul of federal law, reach their own conclusions about which aspects of federal regulatory schemes may be compromised with state law at acceptable cost to the federal scheme. Appellees do not ask whether general corporate funds are burdened by taxes attributable to unused and restricted IPD funds; they assert instead that appellant possessed enough funds to pay the tax. (Motion to Dismiss, p. 6). Likewise, they deem it irrelevant that charging general funds with the obligation to pay a tax on unused restricted funds could disable railroads in Maine from fulfilling IPD quota requirements, because they conclude that "for many railroads, the quota requirement is meaningless." (Motion to Dismiss, p. 7.) And we have already shown (Juris. St., pp. 22-23) how surrender of appellant's IPD funds to other carriers (Motion to Dismiss, p. 9) would frustrate the goals of the IPD program.

II. THE COMMERCE CLAUSE AND DUE PROCESS ISSUES.

Appellees do not deal satisfactorily with either of the principal points of the jurisdictional statement—that unused IPD receipts that must be held in trust in the restricted IPD fund add nothing to the "value of the franchise," and that the application of the mileage apportionment formula was an improper basis for apportioning NROI attributable to freight rental income, composed chiefly of IPD income.

1. Appellees simply ignore the critical failure of the court below to explain how appellant's unused IPD receipts, which must be held in trust in the earmarked IPD fund and which might never be used, justify heavier taxation by adding to the "value of the franchise." (Juris. St., p. 29.)

2. Appellees' discussion of the mileage apportionment formula fares little better than silence. They devote an extended discussion to the subject of NROI, contending that "[t]he apportionment of NROI, in itself, is inconsequential to the fairness of the apportionment of the entire Maine railroad excise tax" (Motion to Dismiss, p. 10) and that NROI, in any event, is "a false indication of the railroad's business activity." (Id., p. 13.) The fact is that the apportionment of NROI is used to determine the tax rate to be applied. A fair apportionment of NROI would have resulted in the application of a lower tax rate, increased the diminishment amount and, because taxes are levied on gross receipts, a far lower tax. We disagree that NROI is a "false indication;" it is a measure of the net operating income of railroads used throughout the railroad industry, and recognized alike by ICC accounting regulations and Section 2624 of the Maine Railroad Excise Tax.[1] In any event, NROI is the measure of income apportioned by the Maine Railroad Excise Tax, and it must be fairly apportioned.

[1] Appellees' speculate about the costs that should be charged to boxcar revenues as opposed to freight revenues. (Motion to Dismiss, pp. 13-14.) They also note that some 92.5 percent of appellant's 1974 revenues were freight revenues. (*Id.*) Accordingly, even if 7.5 percent of costs associated with boxcars were reapportioned (and there are strong reasons why that should not be done) the impact on boxcar rental income would be minor.

CONCLUSION

The Court should note probable jurisdiction and set the case for briefing and argument on the merits.

Respectfully submitted,

PETER J. NICKLES
EUGENE D. GULLAND
MARC B. TUCKER
COVINGTON & BURLING
888 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 452-6000

WILLIAM C. SMITH
JAMES G. GOOD
PIERCE, ATWOOD, SCRIBNER, ALLEN, SMITH & LANCASTER
One Monument Square
Portland, Maine 04111
(207) 773-6411

Attorneys for Maine Central Railroad Company

Of Counsel:
SCOTT W. SCULLY
General Counsel
MAINE CENTRAL RAILROAD COMPANY
242 St. John Street
Portland, Maine 04102
(207) 773-4711

May 1978

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MAINE CENTRAL RAILROAD COMPANY, APPELLANT

v.

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ON APPEAL FROM THE SUPREME JUDICIAL COURT OF MAINE

MEMORANDUM FOR THE UNITED STATES AS AMICUS CURIAE

WADE H. MCCREE, JR.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

ROBERT S. BURKE,
Deputy General Counsel,

HENRI F. RUSH,
Associate General Counsel,
Interstate Commerce Commission,
Washington, D.C. 20423.

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CITATIONS

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ON APPEAL FROM THE SUPREME JUDICIAL COURT OF MAINE

MEMORANDUM FOR THE UNITED STATES AS AMICUS CURIAE

This memorandum is filed in response to the Court's invitation of May 15, 1978.

QUESTION PRESENTED

We address the question whether application of the Maine Railroad Excise Tax to incentive per diem income received by appellant conflicts with the Interstate Commerce Commission's incentive per diem program, and therefore is forbidden by the Supremacy Clause of the United States Constitution.

STATEMENT

A. The Interstate Commerce Commission's Incentive Per Diem Program

To remedy a critical freight car shortage during World War I, Congress enacted the Esch Car Service Act of 1917, 40 Stat. 101, 49 U.S.C. (1964 ed.) 1(14) (a). This statute empowered the Interstate Commerce Commission to prescribe compensatory per diem charges to be paid by railroads using boxcars owned by other carriers. See *United States* v. *Allegheny-Ludlum Steel Corp.*, 406 U.S. 742, 743-744.

Perceiving that the supply of boxcars remained inadequate despite the incentives that had been created by those compensatory per diem charges, Congress authorized the Commission in 1966 to prescribe additional per diem payments. See *United States* v. *Florida East Coast Ry.*, 410 U.S. 224, 230-231. Under Section 1(14)(a) of the Interstate Commerce Act, as amended in 1966, 80 Stat. 168, 49 U.S.C. 1(14)(a), the Commission was authorized to fix per diem compensation in light of the following considerations:

> the Commission shall give consideration to the national level of ownership of such type of freight car and to other facts affecting the adequacy of the national freight car supply, and shall, on the basis of such consideration, determine whether compensation should be computed solely on the basis of elements of ownership expense involved in owning and maintaining such type of freight car, including a fair return on value, or whether such compensation should be increased by such incentive element or elements of compensation as in the Commission's judgment will provide just and reasonable compensation to freight car owners, contribute to sound car service practices (including efficient utilization and distribution of cars), and encourage the acquisition and maintenance of a car supply adequate to meet the needs of commerce and the national defense. * * *

The concern of Congress about the shortage was expressed in the report of the Senate Committee on Commerce on the 1966 amendment:

> Car shortages, which once were confined to the Midwest during harvest seasons, have become increasingly more frequent, more severe, and nationwide in scope as the national freight car supply has plummeted. [S. Rep. No. 386, 89th Cong., 1st Sess. 1-2 (1965).]

Using the authority vested in it by the 1966 amendment, the Commission established a comprehensive incentive per diem (IPD) program with respect to plain unequipped boxcars. See *Incentive Per Diem Charges—1968*, 337 I.C.C. 217 (1970). The Commission's IPD regulations are presently codified in 49 C.F.R. Part 1036, and they have been upheld by this Court.[1]

The regulations prescribe a level of payments that, in the judgment of the Commission, will contribute to sound car service practices and encourage the

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[1] See *United States* v. *Florida East Coast Ry.*, 410 U.S. 224, on remand, 368 F. Supp. 1009 (M.D. Fla.), affirmed, 417 U.S. 901. See also *Illinois Terminal R.R.* v. *United States*, 541 F.2d 201 (C.A. 8), certiorari denied, 430 U.S. 906.

acquisition and maintenance of an adequate car supply. The Commission sought to increase the annual rate of return on investments in unequipped boxcars from 6 percent to 12 percent. It concluded that this relatively high return is necessary to make investment in boxcars a "desirable alternative" to various available business investments. *Incentive Per Diem Charges—1968, supra*, 337 I.C.C. at 224.

The incentive per diem regulations further provide that net balances of IPD receipts collected by carriers, less federal and state income taxes actually paid as a result of receiving such payments, must be segregated and expended only to purchase, build, rebuild or lease boxcars. 49 C.F.R. 1036.3. As the Commission made clear, "[t]he net balances derived from the incentive charge are not properly part of the general working capital of the recipient railroad." *Incentive Per Diem Charges—1968, supra*, 337 I.C.C. at 228. Rather, such receipts are "in effect, held in trust" for use in augmenting the nation's supply of boxcars. *Incentive Per Diem Charges—1968*, 343 I.C.C. 49, 56 (1973). Once the funds have been used to purchase boxcars, however, the boxcars become the unencumbered property of the railroad.

Moreover, a carrier must acquire its "test period quota" of boxcars each year with general corporate funds before expending IPD funds to purchase additional boxcars. To satisfy that quota, the carrier must build, lease, or purchase the number of boxcars that, on the average, it had built, leased, or purchased each year from 1964 through 1968. 49 C.F.R. 1036.4.

This requirement ensures that boxcars acquired with IPD funds are in addition to boxcars that would have been purchased by the carrier in the ordinary course of business. *Incentive Per Diem Charges—1968, supra*, 337 I.C.C. at 228-230.

B. The Present Proceedings

Appellant operates a railroad with lines in Maine, and it is subject to the Maine Railroad Excise Tax, 36 Maine Rev. Stat. Ann. 2623-2628 (1965), as amended (J.S. App. 35a-39a).[2] In 1974 appellant received approximately $1,870,000 in IPD income from other carriers that had used its boxcars (J.S. 10). The State Tax Assessor included that sum in the appellant's net railway operating income (NROI) for purposes of calculating the applicable Maine Railroad Excise Tax. The State Tax Assessor determined that appellant's tax liability for 1975 should be $686,383; the tax liability would have been $70,623 if IPD pay-

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[2] The tax liability of a railroad under the Maine excise tax is based on a percentage of the railroad's gross transportation receipts for the preceding year. The applicable percentage is ascertained by comparing the railroad's net railway operating income for that year with the railroad's gross transportation receipts. (See the appendix to the Mot. to Dismiss or Affirm for a description of those two accounting terms.) When the net railway operating income is 10 percent or less of the gross transportation receipts, the applicable tax percentage is 3¼ percent of the gross transportation receipts. But when the net railway operating income exceeds 10 percent of the gross transportation receipts, the applicable percentage rises and the tax liability is accordingly increased (J.S. App. 2a-3a).

ments had been excluded from the NROI account (J.S. 10-11).[3]

Appellant then brought suit in the Superior Court for Kennebec County, Maine, seeking a declaratory judgment that IPD payments could not properly be included in NROI, and that, if the statute were construed to include IPD payments within the definition of NROI, the statute, as applied, violated the Supremacy Clause of the United States Constitution. The Interstate Commerce Commission filed a brief as *amicus curiae* and supported appellant. The case was certified to the Supreme Judicial Court of Maine for determination on a statement of stipulated facts.

The Commission's brief in that court argued that the state tax should not be interpreted to include IPD receipts in NROI, because that would undermine the IPD program. The Commission explained that receipts must be segregated and expended for the limited purpose of increasing the number of boxcars in the nation's railroad system. By imposing substantial excise tax liabilities on the general corporate funds of railroads receiving IPD payments, the Commission argued, the state either had levied a tax on the IPD monies themselves (which, in the Commission's view, it could not do) or had made it more difficult for the railroads to meet their "test period quota" of new

[3] The inclusion of IPD payments in the Maine Central's 1974 NROI account moved Maine Central into the higher, 3¾ percent tax bracket. It also affected the computation of deductions and exclusions. The latter effect was apparently more important for appellant's 1975 taxes.

cars (see pages 4-5, *supra*), which must be acquired with general corporate funds before IPD funds can be used for additional purchases. This not only created a disincentive, the Commission contended, but also diminished the amount of money available to purchase new boxcars as contemplated by Congress.

The Supreme Judicial Court of Maine rejected the contentions of the Commission, holding that (J.S. App. 16a-17a; footnote omitted; emphasis in original):

> [W]e are satisfied that Maine's inclusion of incentive per diem charges in net railway operating income, for the computation of the Maine excise tax on railroads, has no direct, generalized tendency to affect the federal boxcar incentive program so adversely as to require, by force of the Supremacy Clause of the Constitution of the United States, the nullification of that particular exercise of Maine's power of taxation *by implication* from the existence, and needs, of the Federal program.

DISCUSSION

1. The Interstate Commerce Commission adheres to the views it expressed in the Supreme Judicial Court of Maine. The Commission concurs in the arguments set forth at pages 14-23 of the jurisdictional statement of appellant, which it believes require elaboration only by reference to *McGoldrick* v. *Gulf Oil Corp.*, 309 U.S. 414, 428-429, and *Warren Trading Post Co.* v. *Arizona Tax Commission*, 380 U.S. 685,

691, in which this Court held state tax statutes to be preempted.[4]

2. The United States disagrees with the Commission and concludes that the Maine tax is not preempted. This Court has indicated that state taxes are not lightly to be set aside on grounds of implied preemption. Thus, in *Hines* v. *Davidowitz*, 312 U.S. 52, 68, the Court, while finding a state alien registration statute to be inconsistent with applicable federal legislation, emphasized that state taxation statutes fall within "an entirely different category," and that the states enjoy a "broad base" in levying taxes on local business operations.[5]

The Court stated in *Merrill Lynch, Pierce, Fenner & Smith* v. *Ware*, 414 U.S. 117, 139, that " 'federal

[4] The Commission believes that the Supreme Judicial Court of Maine was wrong in assuming (J.S. App. 16a) that railroads, subject to excise tax liabilities payable out of general corporate revenue, will voluntarily surrender IPD receipts to the "Rail Box" corporation if they should be unable to meet their test period quota of new boxcar purchases and are therefore unable to expend such IPD receipts. No railroad has voluntarily tendered IPD funds to Rail Box; IPD receipts are of considerable value to railroads when converted into rolling stock, and railroads will not readily forego that value.

[5] The Court in *Hines* cited Federalist paper 32, which states that, notwithstanding the Supremacy Clause, the states retain a broad and independent power to raise revenue to any extent of which they may stand in need by every kind of taxation except duties on imports and exports. See also Federalist papers 33 and 34, emphasizing that, in the absence of an immediate constitutional repugnancy, the Supremacy Clause does not abridge state power to levy taxes. See *The Federalist* 240-253 (Wright ed. 1961).

regulation of a field of commerce should not be deemed preemptive of state * * * power in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained'." See also *Braniff Airways, Inc.* v. *Nebraska State Board of Equalization*, 347 U.S. 590, 594-597; *DeCanas* v. *Bica*, 424 U.S. 351, 355-358. And as the Court pointed out in *Exxon Corp.* v. *Governor of Maryland*, No. 77-10, decided June 14, 1978, slip op. 12-13: "[i]n this as is other areas of coincident federal and state regulation, the 'teaching of this Court's decisions * * * enjoins seeking out conflicts between state and federal regulation where none clearly exists.' "

Although a state statute may not stand as " 'an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,' " *Ray* v. *Atlantic Richfield Co.*, No. 76-930, decided March 6, 1978, slip op. 5, the state rule is not preempted unless federal policies actually have been "thwarted" by the "practical operation" of the state statute. *First Federal Savings & Loan Association of Boston* v. *State Tax Commission*, No. 77-334, decided June 15, 1978, slip op. 4. Preemption of an otherwise valid law by implication is rare, because the federal government, through corrective legislation or administrative rulemaking, "remains free to remove the burden" on federal programs that may result from state legislation. *Penn Dairies, Inc.* v. *Milk Control Commission*, 318 U.S. 261, 275. Preemption by implication should be an

extraordinary event indeed when a state tax statute is involved. This follows not only from the caveat in *Hines* but also from the fact that all taxes make the thing taxed less profitable. The federal government regulates (or encourages) many activities. If the disincentive[6] to investment that might be caused by a state tax were enough to preempt the state tax's application to any subject regulated (or encouraged) by federal agencies, much of the states' power to tax would be ousted. Only the plainest command could support such a result.

3. Those principles, applied to the Maine tax and its effect on appellant, lead to the conclusion that the taxation of IPD receipts (and their inclusion in appellant's NROI account) are consistent with the Supremacy Clause of the Constitution.

First, the Commission's regulations do not state expressly that IPD receipts must be disregarded for purposes of state excise tax computation. Indeed, those regulations allow both state and federal income taxes to be paid directly out of the railroad's segregated IPD account. See *Incentive Per Diem Charges —1968*, 343 I.C.C. 49, 55 (1973). Thus, the regulations themselves do not support the argument that state excise tax liability was foreclosed by the Commission in the present circumstances. Nothing of con-

[6] A state tax is a disincentive in the sense that it reduces the absolute attractiveness of profit-making endeavors. But a neutral or flat-rate tax on receipts or profits leaves the *relative* attractiveness of investments unaffected. Moreover, a state rarely would seek to discourage such profit-making endeavors, because that would obliterate the very thing (profits or receipts) from which the state sought to raise revenue.

stitutional dimension should turn on whether a state elects to raise revenue through an income tax (which the federal regulation contemplates), through an excise tax, or through some combination of taxes; any of those routes can lead to the same net tax.

Second, the Maine tax is neutral with regard to federal purposes. It applies to a percentage of the gross transportation receipts of the railroad. The applicable percentage of the gross transportation receipts is determined by reference to the ratio between the railroad's NROI and its gross transportation receipts. IPD income is only one constituent in the NROI account, and it is treated exactly like any other item of net revenue.[7] The tax in question does not penalize IPD receipts or subject them to a discriminatory or disproportionate rate of taxation. Cf. *United States* v. *County of Fresno*, 429 U.S. 452, 462-464. If the state imposed a tax on boxcar revenues higher than its tax on other railroad receipts, this would be a very different case.

Third, appellant easily can comply with both the state and federal provisions. The federal rule gener-

[7] It therefore would not be accurate to contend that the IPD income of appellant caused either the increase in the applicable tax percentage or the change in the computation of deductions and exclusions that led to the especially high tax in 1975. The NROI account includes various income constituents, and no single constitutent can logically be isolated as the marginal factor that caused the higher taxes. The IPD funds and (say) locomotive rentals are treated identically by the state, and the exclusion of either from the tax computations would have decreased the tax.

ates money; the state rule taxes profits from remunerative activity. It is quite true that participation in the IPD program generates income for the purpose of encouraging the ownership of boxcars, but income-producing activities are traditionally subject to state taxation, as the Commission's own regulations acknowledge. And it is equally clear that the state tax does nothing to upset the relative investment priorities implicit in the Commission's IPD program. If boxcar rentals result in a rate of return of 12 percent, which is equal to or above the rate of return available on alternative forms of railroad investment, then the imposition of a neutral tax based on a percentage of the railroad's gross transportation receipts will not diminish the relative attractiveness of boxcar investments vis-a-vis other types of business investment. The return available on boxcar investments will still be more attractive than lower rates of return available on alternative investments, no matter how high the state tax may be (so long as it does not reach 100 percent).

4. We also conclude that the arguments of appellant regarding the disincentives generated by the state tax are not clearly supported by the record. "The sparse evidence introduced on this point * * * is ambiguous at best." *First Federal Savings & Loan Association*, *supra*, slip op. 4 n. 4. Appellant has continued to increase its supply of boxcars (see Mot. to Dismiss or Affirm 6-8),[8] and there is no showing

[8] This is, we think, the almost inevitable consequence of the fact that the Commission has made investments in boxcars

that appellant had insufficient cash, liquid assets, or ability to obtain credit to meet its test period quota in any year. See also J.S. App. 13a n. 8. In addition, as the court below pointed out," [t]he year 1974 was unusual" because of appellant's record earnings (J.S. App. 12a), resulting in an unprecedented increase in appellant's tax bracket. The inclusion of IPD receipts in appellant's NROI account evidently did not increase its tax liability in any preceding year.

With respect to appellant's argument that a railroad subject to excise tax liability payable out of general corporate funds may be prevented from meeting its "test period quota" and thus be barred from expending IPD receipts for new boxcars, we observe that this record does not indicate that appellant has been unable to meet its quota or that such a situation is likely to result recurrently or in a substantial number of other cases with a disruptive effect on the federal IPD program. See *Exxon Corp.* v. *Governor of Maryland*, *supra*, slip op. 12-13: " 'the existence of such potential conflicts is entirely too speculative in the present posture of this case' * * * This sort of hypothetical conflict is not sufficient to warrant preemption."[9]

especially profitable. If it ever were in the interest of appellant to reduce its investments in order to avoid state taxes, surely appellant would eliminate its least profitable investments first.

[9] The Commission relies on *McGoldrick*, *supra*, and *Warren Trading Post Co.*, *supra*, as cases in which this Court found an implied preemption of state taxes. (Appellant cites no

We emphasize once more that this is not a case in which a federal administrative agency has adopted an explicit rule or regulation governing the application of state excise taxes. Where an express prohibition exists under a valid federal regulation, the Supremacy Clause would require that the regulation take precedence over conflicting state laws. See *McGoldrick* v. *Gulf Oil Corp., supra*, 309 U.S. at 426-429; *Free* v. *Bland*, 369 U.S. 663, 666-670; *United States* v. *Mississippi Tax Commission*, 412 U.S. 363, 380.

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case in which taxes have been held preempted by implication.) *McGoldrick* may have been called into question by *Department of Revenue* v. *Association of Washington Stevedoring Companies*, No. 76-1706, decided April 26, 1978. At all events the United States believes that *McGoldrick* involves both a clear statement of congressional purpose and a clear frustration of that purpose by the state tax, which makes it quite unlike the present case. *Warren Trading Post* is irrelevant here, in the view of the United States, because it involves taxation of Indians. Such cases always have been treated as problems of inter-governmental tax immunity rather than as problems of ordinary preemption. See, *e.g.*, *Moe* v. *Confederated Salish and Kootenai Tribes*, 425 U.S. 463.

CONCLUSION

The Commission submits that the Court should note probable jurisdiction and reverse the judgment below. The United States submits that the appeal should be dismissed for want of a substantial federal question.

Respectfully submitted.

WADE H. MCCREE, JR.,
Solicitor General.

ROBERT S. BURKE,
Deputy General Counsel,

HENRI F. RUSH,
Associate General Counsel,
Interstate Commerce Commission.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1373

MAINE CENTRAL RAILROAD COMPANY, *Appellant*,

v.

RAYMOND L. HALPERIN, *et al.*, *Appellees*.

On Appeal From The Supreme Judicial Court of Maine

PETITIONER'S RESPONSE TO THE MEMORANDUM OF THE UNITED STATES AS AMICUS CURIAE

PETER J. NICKLES
EUGENE D. GULLAND
MARC B. TUCKER

COVINGTON & BURLING
888 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 452-6000

WILLIAM C. SMITH
JAMES G. GOOD

PIERCE, ATWOOD, SCRIBNER, ALLEN, SMITH & LANCASTER
One Monument Square
Portland, Maine 04101
(207) 773-6411

Attorneys for Maine Central Railroad Company

Of Counsel:
SCOTT W. SCULLY

General Counsel
MAINE CENTRAL RAILROAD COMPANY
242 St. John Street
Portland, Maine 04102
(207) 773-4711

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PETITIONER'S RESPONSE TO THE MEMORANDUM OF THE UNITED STATES AS AMICUS CURIAE

The United States "disagrees with the Commission and concludes that the Maine tax is not preempted." (U.S. Mem., p. 8.) It bases this position on the fact that the Commission has not "adopted an explicit rule or regulation governing the application of state excise taxes." (*Id.* at 14.) There are two defects in the arguments of the United States. *First,* the Commission has made clear that a measure such as the Maine tax interferes with the federal IPD program. *Second,* the prior decisions of this Court do not establish the constitutional principle, for which the United States here contends, that state tax measures run afoul of the Supremacy Clause only when they conflict with a federal statute or regulation expressly forbidding the imposition of such a tax.

1. The United States fails to address the principal issues presented in the court below and in the jurisdictional statement. It ignores the critical point that the Court below refused to respect the Commission's interpretive rulings and policy statements, antedating this litigation, that IPD funds do not belong to their railroad recipients; that they are held in earmarked funds subject to restrictions in the nature of a trust; and that they become the property of a railroad only in the form of the boxcars that may be acquired with them if a number of conditions are met. (J.S. 17-19.)

Neither the United States nor the court below suggests that the restrictions that the Commission has imposed upon IPD funds are without substance. Neither faces up to the fact that the Maine tax is levied on funds that might never be used to increase the "value of the franchise," or that the Commission could order that they be surrendered. Different and more difficult questions would be presented if the tax were imposed *after* boxcars had been acquired with IPD funds, for the Commission's purpose of encouraging boxcar acquisitions would have been realized, there would be no conflict with stated Commission policies, and the application of the tax would accord with its conception as an impost upon actual increases in franchise value.[1]

[1] Seizing on the fact that the Commission permits the use of IPD funds for payment of state and federal income taxes attributable to IPD income, the United States leaps to the unexplained and unjustified conclusion that the Commission's failure expressly to address excise taxes is an implied authorization of such taxes. (U.S. Mem., p. 10.) It is nothing of the sort. The United States ignores the Commission's refusal to permit IPD funds to be used for payment of the excise tax and the express statement of policy that it "did not envision or intend that [IPD] charges would result in added financial burdens on the corporate earnings and assets of creditor railroads." (R. 202; J.S. 19.) And as this Court has recently noted, " 'where failure of . . . federal officials affirmatively to exercise their full authority takes on the character of a ruling that no such regulation is appropriate or approved, pursuant to the policy of the statute,' States are not permitted to use their . . . power to enact such a regulation." Ray v. Atlantic Richfield Co., —— U.S. —— (No. 76-930, decided March 6, 1978), slip. op. at 24.

The Commission was justified in doubting its authority to shield IPD income from federal income taxes; having permitted payment of federal taxes out of IPD income, it could properly determine that comity warrants payment of state income taxes attributable to IPD receipts and that such state taxes should also be paid out of IPD funds. The Commission is free to make one such exception to the trust restrictions it imposes on the funds without eliminating all such restrictions.

The United States does not, and could not, dispute the uncontradicted evidence below—adduced chiefly by the Commission itself—that application of the Maine tax interfered with the Commission's target rate of return on boxcars; burdened general corporate funds that the Commission intended to shield from taxes attributable to IPD income and that must be used to satisfy quota requirements; and actually made it disadvantageous for petitioner to acquire additional boxcars that would earn additional IPD. (J.S. 19-23.)

Rather than defer to the Commission's expert judgments, the United States—like the court below—engages in its own analysis of the relative importance of component parts of the IPD program. Thus, the United States asserts that "the state tax does nothing to upset the relative investment priorities implicit in the Commission's program." (U.S. Mem., p. 21.) In fact, the reverse is true. The very rationale of the IPD program is that railroads will invest in boxcars

if the investment is more attractive than non-transportation alternatives. (J.S. 20.) Since NROI and gross transportation receipts—the bases for computing the excise tax—can be earned only from railroad-related operations, application of the excise tax to IPD receipts discourages railroads from acquiring boxcars that will increase their IPD receipts. That is particularly likely to occur where IPD receipts cannot be used because of the railroad's inability to satisfy IPD quota requirements. Indeed, the one way open to petitioner to follow the suggestion of the court below and limit IPD receipts through "financial planning" is to stop acquiring boxcars. (J.S. 22.)

The United States contends that the excise tax diminishes the rate of return on all railroad investments in equal proportion (U.S. Mem., p. 21)—but ignores that railroads may place their money in non-transportation investments that are not subject to the tax. And the assertion that "the Maine tax is neutral with regard to federal purposes" (*id.*, at 11) overlooks that the Commission's intentions are not "neutral" with respect to railroad receipts of IPD funds.[2]

[2] The tension in the argument adopted by the United States appears clearly in its efforts to minimize the conflict between the Maine tax and the IPD program that both it and the court below could not ignore. Thus, the United States quotes the observation of the court below that " 'the year 1974 was unusual' because of appellant's record earnings." (U.S. Mem., p. 13.) It asserts that "the record does not indicate that . . . such a situation is likely to result recurrently or in a substantial number of other cases with a disruptive effect on the IPD program." (*Id.*) The United States does not—and could not—cite any decision of this Court holding that the scale or frequency of conflict between state enactments and a federal program is a relevant factor in determining whether federal law shall prevail.

2. No decision of this Court establishes that the application of the Maine tax challenged here must fail because of the Commission's failure to "state expressly that IPD receipts must be disregarded for purposes of state excise tax computation." (*Id.*, at 10.) The United States defends this novel and potentially far-reaching doctrine—which it would have this Court adopt in a summary affirmance—with the argument that both Congress and federal agencies should be required to identify in express terms those specific state taxes they intend to prohibit. (*Id.*, at 9.)

It is surely open to serious doubt whether it is practical for Congress and the federal agencies to anticipate all the possible forms of state taxation that could interfere with federal objectives.[3] And it is equally inadmissible to contend that federal programs must suffer some hindrance until Congress or an agency can discover and remove the interference. It is precisely such considerations that underlie the longstanding principle that the ultimate task of the courts is " 'to determine whether, under the circumstances of this particular case, [the State's] law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' " *Jones* v. *Rath Packing Co.*, 430 U.S. 519, 526 (1977) (*see* J.S. 16 for numerous citations approving this formulation.) The courts do not confine their inquiry as narrowly as the United States would have it; they "consider the relationship between state and federal laws as they are interpreted and applied,

[3] We believe that no other state imposes an excise tax upon IPD receipts.

not merely as they are written." *Id.,* at 526; *see also Savage* v. *Jones,* 225 U.S. 501, 533 (1912).[4]

The United States repeatedly characterizes this as a case of "implied preemption," a concept that is apparently meant to suggest that this Court typically adjudicates cases in which the conflict between state and federal policies is clear on the face of statutes and regulations. It hardly needs be said that such square conflicts are rare. More rarely still do they reach this Court. The proof of the point lies in the fact that, even in cases of the most sweeping preemption—where federal intent to preempt must perforce be the clearest—the Court has refused to hold that the intention to preempt must be stated expressly. The United States quotes dicta from a number of these cases,[5] which involve situations in which "state regulation, although harmonious with federal

[4] We agree with the Commission that McGoldrick v. Gulf Oil Corp., 309 U.S. 414, 428-29 (1940), and Warren Trading Post Co. v. Arizona Tax Comm'n, 380 U.S. 685, 691 (1965), confirm the error of the decision below. The weakness of the United States' efforts to distinguish the cases is reflected by the cryptic, off-handed and incorrect statement that "*McGoldrick* may have been called into question by Department of Revenue v. Ass'n of Washington Stevedoring Companies, No. 76-1706, decided April 26, 1978." Nor is *McGoldrick* a case of preemption appearing expressly on the face of the federal statute or regulation: the regulatory exemption applied only to imported oil "in bonded warehouses," but the Court read the exemption to apply to oil even after its removal from such warehouses.

Similarly, the attempt of the United States to cast off *Warren Trading Post* as involving "problems of inter-governmental tax immunity" rather than "ordinary preemption" (U.S. Mem., p. 14 n.9), does not withstand a reading of *Warren Trading Post,* which turns on standard preemption analysis.

[5] De Canas v. Bica, 424 U.S. 351 (1976); Merrill Lynch, Pierce, Fenner & Smith v. Ware, 414 U.S. 117 (1973); Braniff Airways, Inc. v. Nebraska State Board of Equalization, 347 U.S. 590 (1954); Hines v. Davidowitz, 312 U.S. 52 (1941).

regulation, must nevertheless be invalidated under the Supremacy Clause" because Congress has manifested an "intent to 'occupy the field.' " *De Canas* v. *Bica,* 424 U.S. 351, 356, 357 n.5 (1976). Federalism does not lightly permit the fencing off of entire areas in which the states are not free to legislate at all; in such cases there must be an unmistakable expression of intent to command "a complete ouster of state power—including state power to promulgate laws not in conflict with federal laws." *Id.,* at 357. If any class of cases would establish the rule for which the United States contends, the cases inferring preemption from comprehensive regulation would. They do not.[6] Indeed, this Court has made clear in these cases that, "It has long been the rule that exclusion of state action may be implied from the nature of the legislation and the subject matter although express declaration of such result is wanting." *Bethlehem Steel Co.* v. *New York State Labor Relations Board,* 330 U.S. 767, 772 (1947); cited with approval in *Ray* v. *Atlantic Richfield, supra.*

This case, by contrast, does not foreclose an entire subject matter from state legislative powers. It does

[6] It was in such a case of preemption by comprehensive regulation that the Court, in Hines v. Davidowitz, 312 U.S. 52, 68 (1941) wrote the dicta concerning state taxation powers upon which the United States so heavily relies. (U.S. Mem., p. 8.) Far from carving out any preferred place for state tax measures, it is plain in context that the Court meant to allay concerns that the states' power to tax could be broadly preempted by federal law in the same manner as the States' more limited power to deal with resident aliens. The Court therefore did not suggest that state tax statutes should be accorded more deference than any ordinary state measure. At the same time, the Court reaffirmed that the function of the courts "is to determine whether, under the circumstances of this particular case, Pennsylvania's law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." 312 U.S. at 67.

not require a court to infer from general statements of policy by Congress or an agency whether the full measure of federal purposes and objectives is burdened by a state enactment. Here, the federal agency charged with shaping and implementing an important federal program has stated that the Maine tax conflicts with that program.

CONCLUSION

The views of the United States are based on a novel doctrine never adopted by this Court. The conflicting positions of the United States and the Commission underscore that the questions presented are substantial. The jurisdictional statement raises an additional substantial question that the United States does not address. Accordingly, the Court should note probable jurisdiction and set the case for argument on the merits.

Respectfully submitted,

PETER J. NICKLES
EUGENE D. GULLAND
MARC B. TUCKER

COVINGTON & BURLING
888 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 452-6000

WILLIAM C. SMITH
JAMES G. GOOD

PIERCE, ATWOOD, SCRIBNER, ALLEN, SMITH & LANCASTER
One Monument Square
Portland, Maine 04101
(207) 773-6411

Attorneys for Maine Central Railroad Company

Of Counsel:

SCOTT W. SCULLY

General Counsel
MAINE CENTRAL RAILROAD COMPANY
242 St. John Street
Portland, Maine 04102
(207) 773-4711

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